2020 August Market Update (Getting Ready for the Next Bull Market)

My normal Market Update provides bullish and bearish trends in the market, valuations, the technicals, and the psychology of the markets. The bull market and economic cycle of 2009 to 2020 is over, so this Update will be different and will focus on getting ready for the next bull market and economic cycle. I will compare stocks that investors should be cautious towards because they're overvalued and stocks that are undervalued that might have better risk-reward potential. I will also provide my strategy for this part of the cycle.

The examples I provide are for - EDUCATIONAL PURPOSES ONLY AND ARE NOT BUY OR SELL RECOMMENDATIONS.

As I and many other investment experts are stating – the key to an economic recovery is controlling the virus. A vaccine and treatments could be the key to controlling the virus.

Why is the Market So Strong?

Below are some of the reasons for the stock market's strength. I do provide a contrary view for each bullish view.

- Because of the lockdown, the Federal Reserve anticipated that the economic damage would be significant so the action taken by the Fed and lawmakers was fast and dramatic.

  Strong fiscal (government spending, aid, relief) and monetary efforts (global central banks increasing liquidity into financial markets) have provided trillions of dollars, euros, yen… liquidity to the global financial markets and these efforts have stabilized the money, credit and equity markets. Action from the Fed with lots of liquidity and lawmakers aid/relief are the main reason for the market's resilience, for now.

Below is a chart of the market the day the Federal Reserve had a press conference:

The markets were stable with a bullish bias before the Fed news conference. At the start of the conference Chairman Powell basically said they would do all they can to provide the monetary help the U.S. economy needs and the market rallied – the Fed put/protection was intact. He then said that the economy faced headwinds from the health/financial crisis and lawmakers needs to do more because there is only so much the Fed could do, the market then sold off. The market did recover and was able to end the day higher.

The above chart also provides another clue to this market, how algorithms and computerized trading impacts the market. As the chart shows, the markets are made more volatile with program and algorithm trading as it responds to news. These algorithms seem to weigh positive news higher versus bad news. The Fed said the economy needed more help from lawmakers because the economy faced headwinds. The algorithms did not have a sustained response that the economy faced headwinds and needed help from lawmakers.

So far, lawmakers have not passed phase IV to help small businesses and the unemployed, help the Fed said it needed. The markets have not reacted to this failure.

Contrary view. Trillions of dollars have been released into the global and U.S. economy. The question is – will these trillions of dollars be allocated to the areas of the economy that needs it the most (workers and small businesses) and quickly. The answer to this from the past and currently is no. When companies make mistakes with capital allocation, the mistakes are not as consequential as when the government does, especially with this amount of money.

- There is a belief that there will be a vaccine by the end of the year. I've read many articles, reports about the global vaccine and therapeutic efforts. Experts believe some have very good prospects. If this happens, life and the economy can get back to normal. The market has focused on vaccines and is probably up about 20% off the bottom because of positive news about vaccines.

Again, I've read many articles (mostly from financial news sources) and they bring up several important questions:

How safe is the vaccine, and what are the side effects?

How effective will it be?

How long will the vaccine last, a lifetime or, a few months?

How long will it take for the nation to be vaccinated?

What if it takes more time to develop a safe, effective vaccine?

What happens if we don't get a vaccine?

Will there be enough supplies for the U.S? Because this is a global problem will there be enough vaccines for the rest of the world? We will need billions of vaccinations.

The above questions and answers will determine how many people will get vaccinated, a more important question

The markets can't answer these questions and are getting ahead of themselves in terms of a vaccine.

- Once we flatten the curve on infections, we can start opening up the economy and the economy can have a V-shaped recovery.

Unfortunately, other parts of the country had spikes in infections, and deaths from the virus. Even though there is not a forced locked down, most citizens are afraid of being infected and were starting to see the dampening of consumer spending. The longer consumers are cautious, it will be difficult for the economy to recovery because the U.S. consumer is 70% of the economy. The longer it takes to provide a vaccine, the more damage we can expect to the economy.

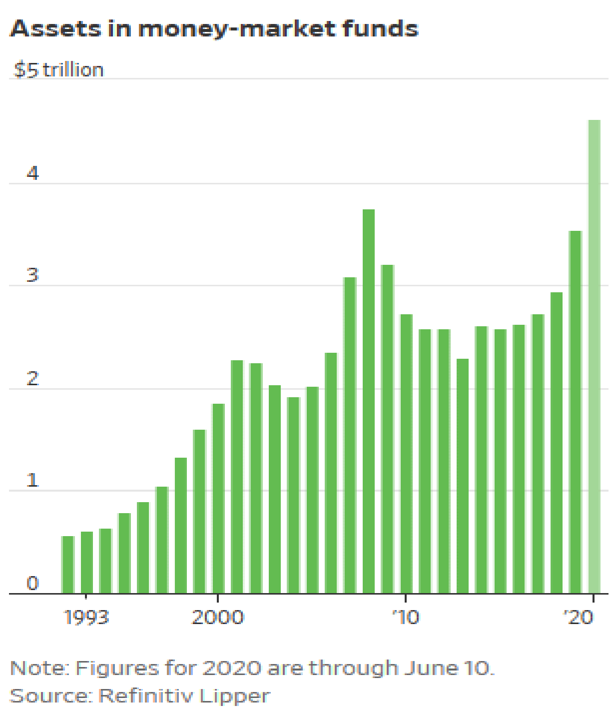
Health experts are expecting a second wave in the fall, winter with the regular flu and cold season.

The v-shaped recovery thesis is dead.

Other Reasons for the Strength of the Market Despite Being in a Deep Recession

- TINA, **T**here **I**s **N**o **A**lternative. The market is focused on about 20 stocks and there are thousands of stocks that have better valuations. Even though cash is not paying much, the return of your money is more important than the return on your money during times like this. It's okay to have cash equivalents, money markets as they are parking places until better investment opportunities with appropriate risk-reward potential arise.

- FOMO, **F**ear **O**f **M**issing **O**ut. This reason is legitimate. There is about $5 trillion sitting on the sidelines waiting to get invested, see chart below. This includes my clients and me.



- During the last bull market, investors learned to buy on dips, participants continue to buy on dips. One of the reasons why we don't have sustained drops in the markets.

- There are many market cheerleaders and bulls on CNBC and Fox Business cheering the bulls on.

- The markets dismiss bad news and rally on good news. The market has rallied about 20% just on positive vaccine/treatment news. The market could probably rally another 10% based on an actual approval. As I wrote in the previous page a lot of questions remain regarding an approved vaccine.

- I've been investing for about 40 years and I've seen dramatic changes in the markets and especially participants. The main changes include: 1. Computerization, especially short-term trading decision making 2. ETFs surpass mutual funds in assets under management 3. Financial Planners overtake brokers. Most financial institutions (insurance companies, banks, brokers, and other investment firms) have Financial Planners/Wealth Advisors. These advisors rarely pick individual stocks and prefer ETFs for their client portfolios.

Stockbrokers and mutual fund managers would raise cash, reduce risks during turbulent times, and bear markets. ETFs will not raise cash as most are fixed investments. Financial planners tell their clients that their portfolios are safe because of the diversification of their portfolio and that you can't time the market, so they won't sell client assets during markets like this. ETFs and financial planners are not selling and may not – for now.

In this market, the main participants are hedge funds, institutional investors (insurance companies, pension funds, charitable foundations) financial planners, trend followers, momentum players, and speculators. Below is a chart that shows the action of some of these participants:

Let's review the chart:

- The market had one of the fastest declines into a bear market in market history. In less than a month the market lost about 35%. According to the WSJ, most of the selling was from overleveraged hedge funds. Short-term trend followers and momentum players were also selling. Once the selling started, these participants then went short, accelerating the fall.

- Once relief from lawmakers and liquidity from the Fed was announced, short-term traders had to cover their short positions and other participants believed the Fed put was in play.

- From April to May, the market formed a rectangle formation and is normal after a big move. A rectangle formation, sideways movement, is normally a pause in a move. Despite all the bad news (the virus was spreading in the U.S. and globally, a contracting economy, millions unemployed, small businesses lodging, airlines, restaurants, entertainment, retail stores have all been decimated, bankruptcies) most participants did not sell.

  As mentioned above, ETFs and financial planners will do little selling for the reasons listed above. We can see a slight bullish bias. Prices were able to break out of the rectangle formation and the bullish trend resumed.

  We all so see little selling each day. There is some selling at the start of the day by short-term traders and then the buyers come in after the morning selling.

  There was another rectangle, pause from April to July. We can see toward the end of the formation, there was little selling and prices were able to resume its upward trend. Prices are close to a breakout.

- Prices made a new high back in February and prices may break above the February all-time high. Any good news regarding vaccines, another aid package from lawmakers are potential news that can cause prices to break to new highs. As I've explained many times, when prices break to new highs it would be normal for prices to keep making new highs because most of the sellers are out of the way.

- The rally in the markets is masking the real problems (a deep contraction of the U.S. and global economies. massive unemployment, bankruptcies, too much debt, and large deficits, uncertainty especially when it comes to ending the virus/health crisis)

- As mentioned above, ETFs and financial planners dominate investing. The problem with this is that many financial planners and 401k investors are buying the same thing making these investments crowded and expensive.

If we look at the largest ETFs and mutual funds, they all own the same stocks:

SPDR S&P 500 ETF Trust (SPY)

Add to watchlist

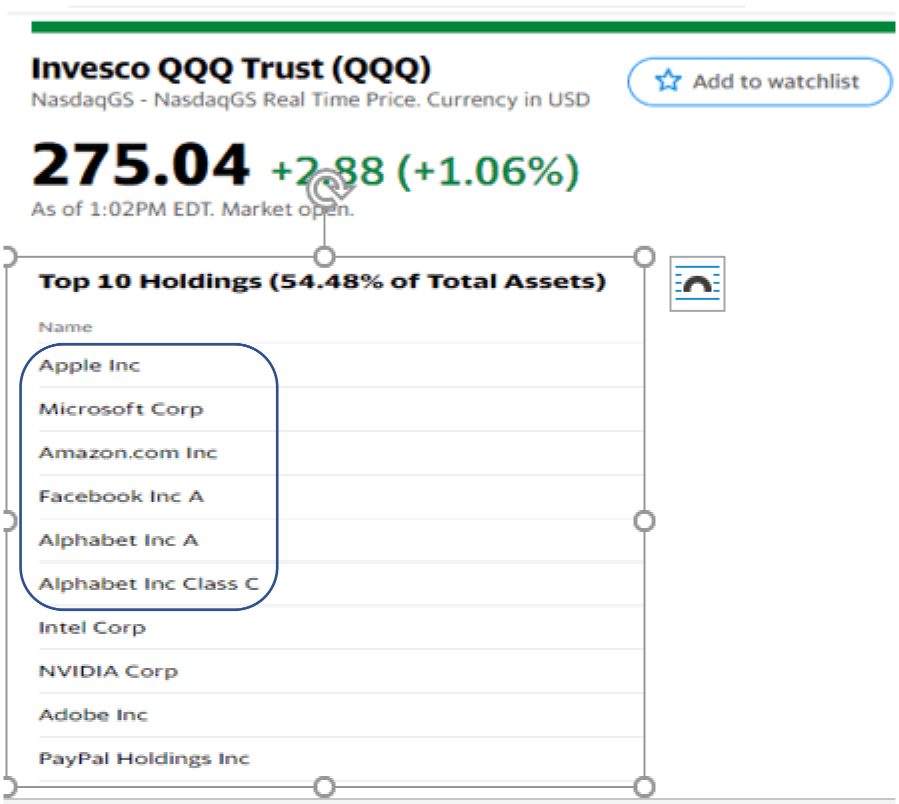
NYSEArca - Nasdaq Real Time Price. Currency in USD

338.15 +1.31 (+0.39%)

As of 12:49PM EDT. Market open.

Top 10 Holdings (26.86% of Total Assets)

Name
Microsoft Corp
Apple Inc
Amazon.com Inc
Facebook Inc A
Alphabet Inc A
Alphabet Inc Class C
Johnson & Johnson
Berkshire Hathaway Inc Class B
Visa Inc Class A
Procter & Gamble Co



The QQQs are the NASDAQ top 100 companies. The QQQs are dominated by technology stocks.

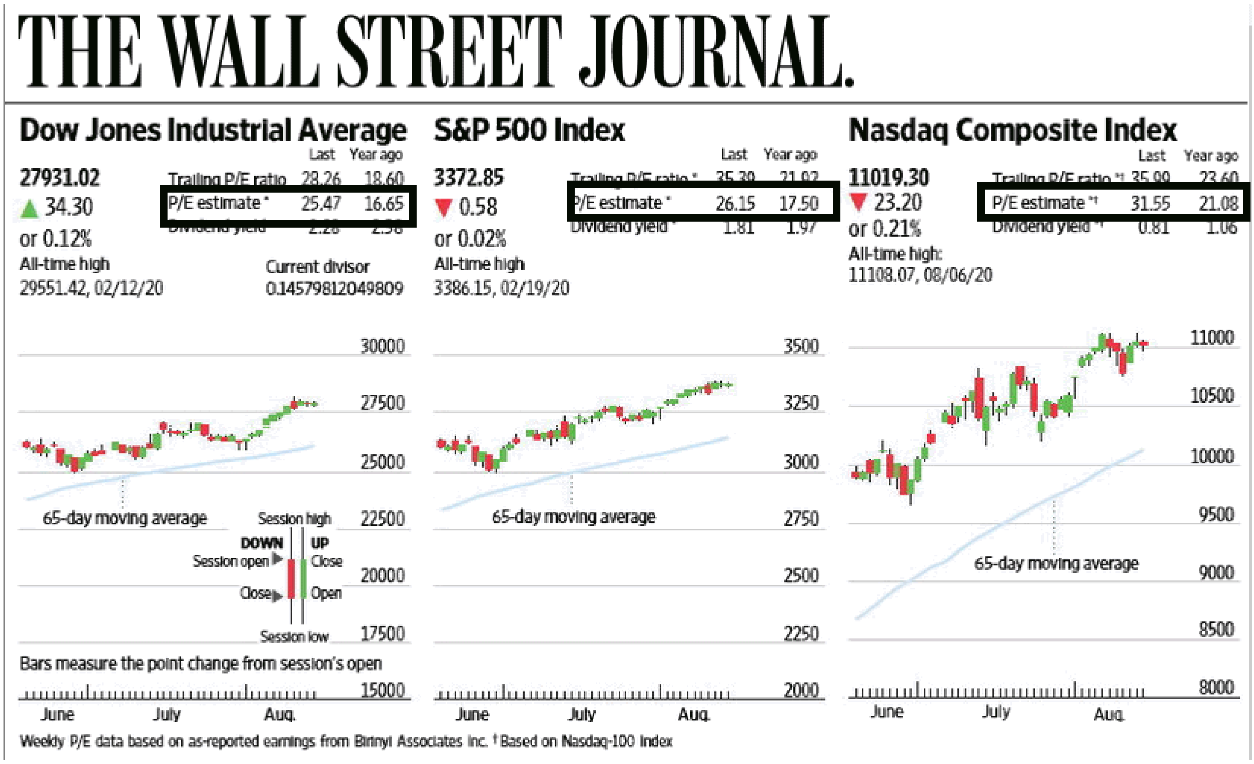
These two indexes through ETFs and mutual funds have about $11 trillion.

When money from financial planners and 401ks is invested, there is a high probability that the money will go into the 5 stocks that are crowded, and expensive. This is not the place to be as an investor.

Areas of the Market That Are Overvalued and Undervalued

I wrote above that the markets are dominated by hedge funds, trend followers, speculators, financial planners, and 401K investors. When I watch cable financial news they rarely talk about valuations. The decision-making process of most of these participants does not include valuations. This is a big mistake, as valuations are extremely important. Investors need to understand what value your company would have if it were acquired or liquidated

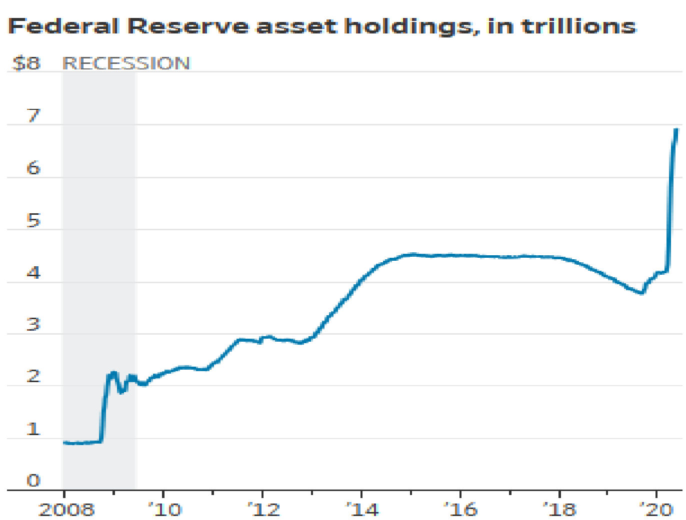
The problem is the markets are very overvalued:



The average historical P/E ratio is about 16 (see J.P. Morgan chart on next page). These markets are expensive, and its P/Es are at historical highs.

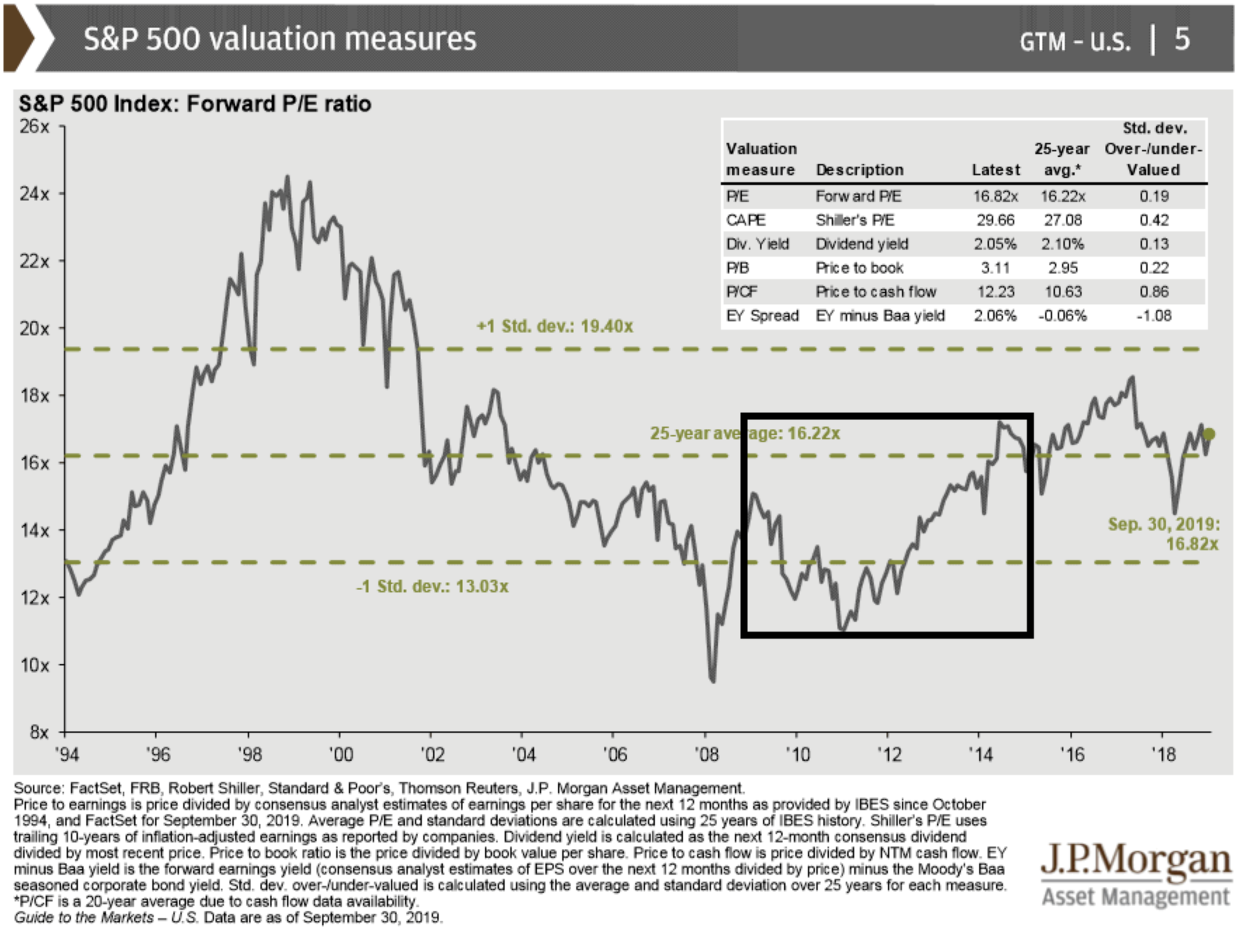
Some analysts explain that all the liquidity drove down most interest rates and therefore making stocks look more attractive driving up values.

If this was true then P/Es should have expanded to these levels in the last market cycle. Here is a chart of the Fed's balance and the liquidity they've been providing:



Source: WSJ

During the last bull market cycle, the Fed's balance sheet ballooned from around $1 trillion to almost $5 trillion. Below is a historical chart of P/E ratios.



Even though the Fed's balance sheet exploded, P/Es never got overvalued. As the chart indicates, current P/Es are at historically high levels.

Not all stocks are expensive. Below I compare the popular expensive stocks and areas in the market that are undervalued.

Nordstrom Versus Amazon

The market capitalization for Amazon is about $1.5 trillion. Investors are paying about $5 for a dollar of sales, and about $144 for a dollar of earnings. Amazon's profit margin is about 5% with sales of about $300 billion, allow for growth it would take an investor about 50 years to break even. Amazon is very expensive.

Description	Market Cap	P/E (ttm)	d Yield	Last Trade	High 52 Wk	Low 52 Wk	% YTD Chg	CRNT PX TO 52 WK HIGH
Amazon.Com Inc	1,522.20B	144.89	--	3,136.27	3,344.29	1,626.03	+69.73	6.63%
Nordstrom Inc	2.19B	--	--	14.04	43.37	12.27	-65.70	208.90%

Nordstrom’s market capitalization is about $2.19 billion so investors are paying about 15 cents for a dollar of sales, much cheaper than $5 for Amazon. When Nordstrom becomes profitable and using their average profit margin, it would take an investor about four years to break even. Norsdstrom is undervalued. Also, after a bear market, it takes about less than three years to reach its old highs. If this happens to Nordstrom, it could be up over 200%.

Here is a long-term chart for Nordstrom:

In the last market cycle, Nordstrom fell to $6. By 2015 the stock rose to about $80. The stock is currently around $15, so if the stock appreciates to last year’s high, the stock would be up about 200%.

In 2018, the Nordstrom family offered to take the company private for about $8 billion, a significantly higher valuation than today’s valuation. Norstrom does have about $3.5 billion in long-term debt.

Below is a chart for Amazon:

The success of Amazon is undisputed, but the stock has gone parabolic and is a sign of speculation. Again, the market capitalization of Amazon is about $1.5 trillion if the stock was to move up 200% its market capitalization would be about $6 trillion making it the third-largest economy in the world. I doubt this would happen.

Apple Versus Exxon

Apple has been a favorite for investors for many years. Its market value is about $2 trillion. Until last year, we have never had a stock worth over $1 trillion. The P/E is a high of about 34, much higher than its growth rate. Apple does have high-profit margins, close to 25%. It would take about 30 years to break even with 25% margins with a high valuation of about $2 trillion.

Description	Market Cap	P/E (ttm)	d Yield	Last Trade	High 52 Wk	Low 52 Wk	% YTD Chg	CRNT PX TO 52 WK HIGH
Apple Inc	1.932 T	34.28	0.75	457.61	464.17	192.58	+55.88	-1.38%
Exxon Mobil Corp	177 B	16.52	8.30	41.91	75.18	30.11	-39.95	79.38%

I chose Exxon as a comparison because iPhone owners believe they can't live without their iPhone. The global economy can not go without oil for a single day. A barrel of oil is more important than an iPhone.

Exxon's market capitalization is about $177 billion and is undervalued with an 8.3% dividend. Exxon has about 22.4 billion barrels of proved oil reserves. The average price of a barrel of oil in a buyout is about $25 a barrel. This would give Exxon oil reserves a value of about $566 billion. They also have refining, gas stations, pipelines, petrochemical operations that are worth at least $100 billion. Exxon liquidation value is much higher than its market value, again with an 8;3% dividend yield. Exxon is undervalued.

Below is an extra long-term chart for Apple:

Apple went public in the early 1980s and it was dead money for about 30 years. The innovative and popular iPhone was a big hit and changed the fortunes for Apple. The stock is parabolic and is a sign of speculation, not investing.

After the Fed increased its balance sheet to shore up the debt and money markets forcing interest rates down, stocks like XOM did rally off their lows because of their high dividends.

The stock is now basing. Basing (moving sideways after bottoming) is normal during a bear market.

There are many stocks in banking, energy, retail, airlines, hotels, restaurants that are basing. If we were going to have a v-shaped economic recovery then these stocks would look the major averages.

Again, basing is normal during a bear market. Investors are waiting to see improvements in the economy and these companies.

I'm more interested in these basing stocks that have good dividends and are undervalued versus stocks that are very expensive and have parabolic moves.

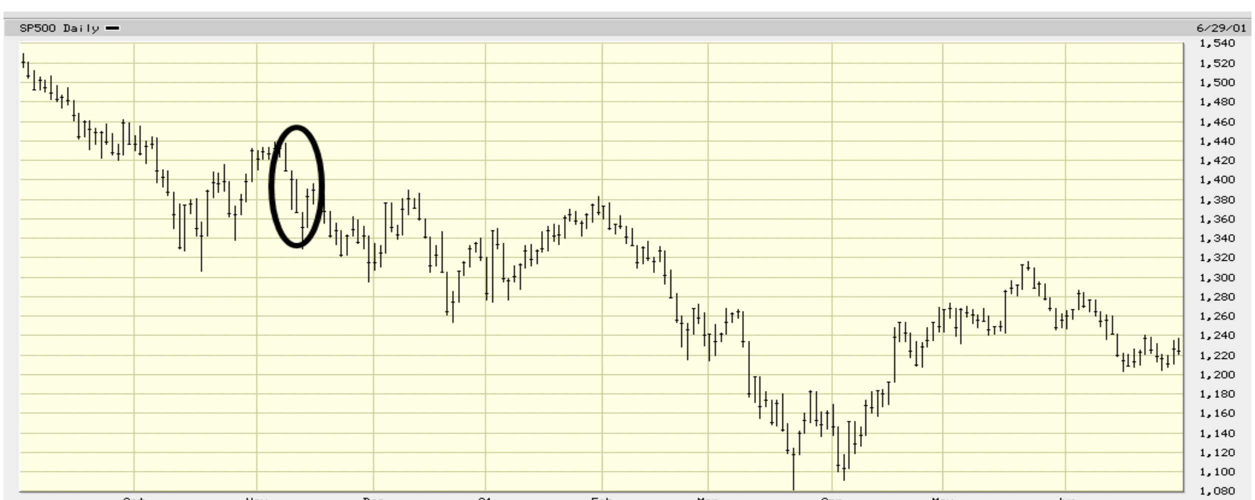
The Scenario for a Test of the March Lows (W-Shaped Market)

If we get a second test of the lows, it would be a good time to get invested for the next bull market cycle. Below are many of the concerns that the market has not factored into the pricing and valuations of stocks and markets and could make the markets test the March lows.

- Many health experts are warning that we could have a second wave of infections during the normal flu and cold season complicating controlling the spread of the virus. Some believe it could be worse than the first wave. The markets have not adjusted for the prospects of a second wave of infections. This could give us a double-dip recession and a w-shaped market.

- Election cycle research shows that if there is a major change in economic policies, then the markets adjust accordingly. If Biden wins, then there could be major changes and direction of economic policies. See the chart below.

- Elections and the repeat of the 2000 election, but worse. The President has stated, "if I lose it's because the election is rigged". We can expect lawsuits causing confusion in the economy and markets. Here is what happened in 2000, the last time an election was contested in the courts.



Let's review the chart:

First, there are several similarities between 2000 and 2020: 1. An election year. 2. A market that was overvalued (see J.P Morgan P/E chart) 3. Too much money was in overvalued technology 4. New entrants in the market who were focused on technology stocks and did not understand how to invest/speculate. This year we have Robinhood traders, speculators, and investors.

The elections were close, but there were problems with the Florida vote count. Lawsuits were filed on both sides that wound up at the Supreme Court. The court ruled in W. Bush's favor and Al Gore accepted the decision.

There was a brief, short rally after the decision and acceptance., but the market resumed its bearish trend.

The market fell over 25% from the election to March.

Many doubt that Donald Trump and his voters would accept a Supreme Court ruling, not in his favor. The delay in deciding the presidential election could play out like 2000.

- 40% of companies in the S & P are not providing revenue and profit guidance. Again, technical/price analysis becomes more important than fundamentals. The technicals show many stocks in parabolic moves, a sign of speculation. Investors should be cautious regarding stocks that have gone parabolic.

  Personally, for my clients and myself, I'm interested in stocks that are basing and with a high, safe dividend. See KBWB chart below.

- There are many stocks in banking, energy, lodging, entertainment, restaurants, airlines, retail that are basing. If we were going to have a v-shaped economic recovery then these stocks would have v-shaped patterns.

Here is a chart of a bank ETF, symbol KBWB:

Like many banking stocks, this ETF pays a dividend of about 4% (some dividend bank paying stocks could cut their dividend if the recession gets worse). We normally can't have an economic recovery unless we have a healthy banking system. Banks normally increase their loan loss reserves, increase their lending standards, and cuts costs during a recession. Most banks have been taking all these actions during this recession.

The bank ETF, KBWB, is down about 35% and is basing. Again, bases are like diving boards, the longer the diving board the better the bounce. The major markets have not built sturdy basing patterns which means the current parabolic moves are on shaking ground. I used the chart below in previous Market Updates to show how shaky the market patterns are.

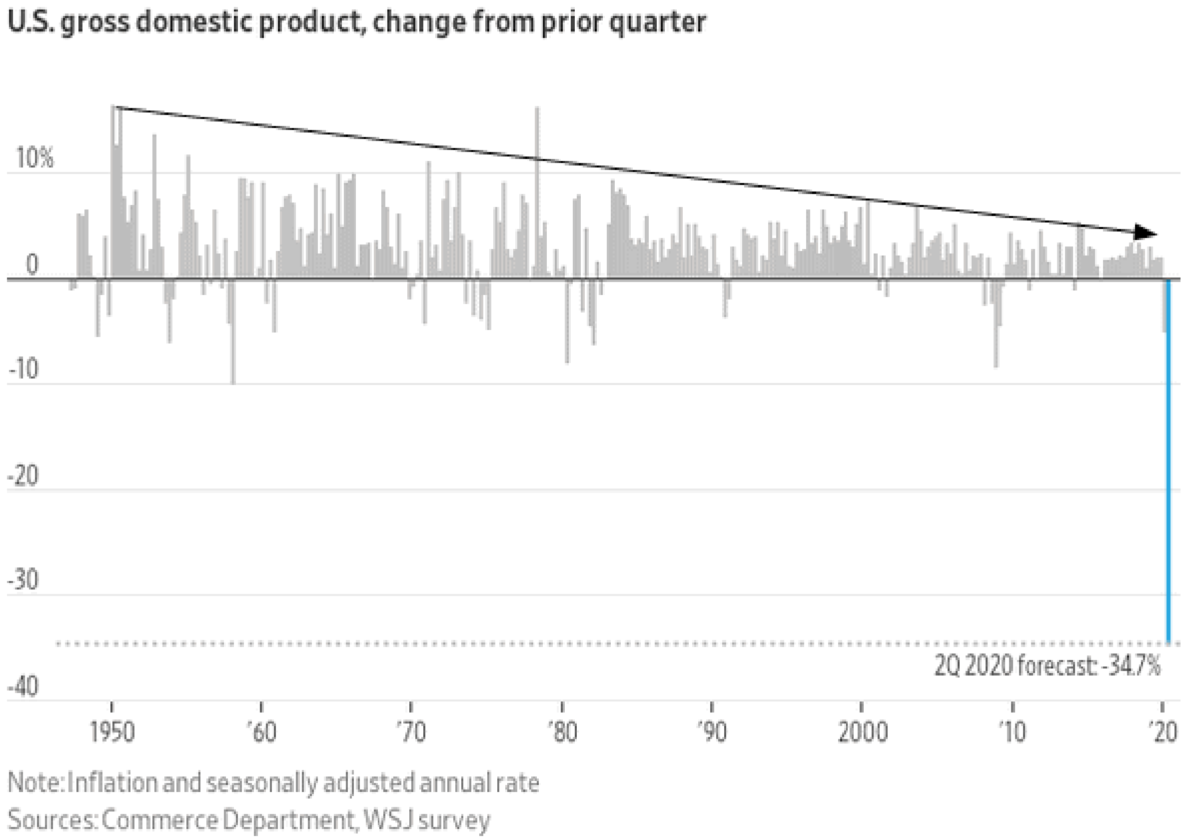
What I pointed out with this chart, is that each pullback that is circled was lower, a declining bottoms trendline. This is bearish. More importantly, the market did not base long enough so each rally was suspect. The current rally is not on solid footing. As I write about above, most of its assumptions about a v-shaped recovery are wrong. This is why basing is important, we need to see improvements in an economic recovery and this takes time. There are too many uncertainties regarding the U.S. and global economy.

- The day after the elections, President Trump’s economic team was promoting the President’s economic agenda of tax cuts, deregulation, and trade negotiations. In the last few years, his team has been talking up: the new NAFTA, and a China trade deal; the Fed and its need to lower rates; this year vaccine news, monetary and fiscal aid, relief and liquidity.

The markets will not have Trump's economic team pushing up the markets. These visits from Trump’s economic team have pumped up the markets. Many of the visits happen when the markets start to drift lower. If Trump is not re-elected, then the markets will not have the Trump economic team pumping up the markets and the markets could act more normally by adjusting to both good and bad news.

- The markets have pulled performance forward for at least a year. The market is discounting a strong recovery and strong earnings growth. Below I make a case that this may not happen, so the markets could continue to struggle and at best it will be stuck in the trading range its been in for about the last four years.

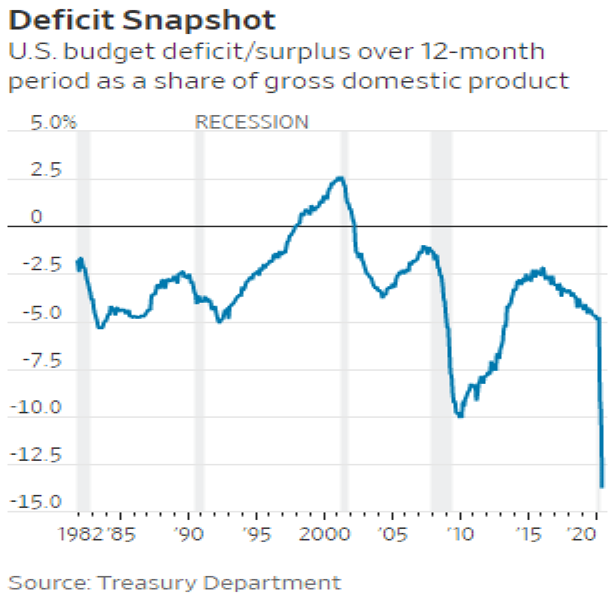
- The President would deserve to be re-elected if it were true that he created the best economy in history. IT IS NOT TRUE. Below is a chart of our GDP going back to 1950:



It is easier to grow an economy 10% when it is less than $ 1 trillion, but not when it's a $20 trillion economy. This is an example of the law of large numbers. The slower growth is not President Trump's fault. I hear too often on cable news that we had a booming economy and that the President can bring back a booming economy. WE DID NOT HAVE A BOOMING ECONOMY. We now have the worst economy post-WWII.

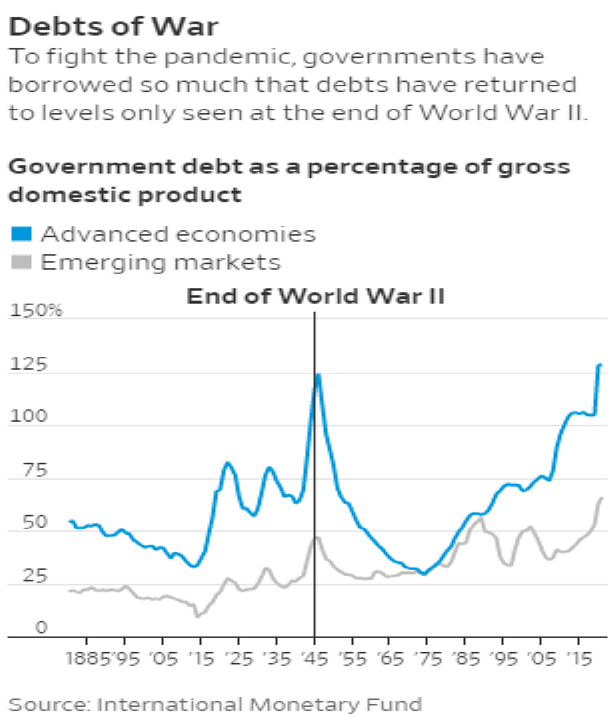
If the President is not re-elected, then the market will have to wake up to the reality that the economy is not booming, corporate taxes will probably go up hurting profits. The market will have to adjust to a slower economy and slower growth in corporate profits.

- Our deficits (more expenses than revenue/taxes) have exploded:



When you spend more than you take in, the deficit is normally financed by issuing debt.

- Most of the major economies of the world have too much debt, including the U.S.



Global and U.S. debt has passed WWII levels. Again, resources have to be used to service the debt instead of productive assets. Too much debt is a headwind.

- There is also too much debt at the state and local levels Corporations also have too much debt.

- If we do have a second wave of infections, and we get another test of the lows, experienced 401k investors may reallocate assets to safer choices like money market funds. The selling of ETFs and target funds could cause more selling in the markets.

- Just as some 401k investors might pull money out of the markets if we have a w-shaped market, some financial planner's customers could do the same if they get a couple of quarters of bad statements with falling prices, values.

- Most recessions have a negative feedback loop of layoffs, bankruptcies, bad earnings, a contraction in the economy… We are seeing that now, but the market doesn't react to the bad news. If we get a double-dip recession and another test of the low, the market could act like a normal bear market with prices basing.

- The market is probably up by 20% based on a vaccine, and therapeutics news. The market is expecting a vaccine by the end of the year. Some health experts believe a vaccine may not be available for the general public until early next year or next spring. What if we don't have an effective, safe vaccine. The markets have not priced in a late or no vaccine. A lot of damage to the economy can continue between now and global vaccinations.

Current Personal Investment Strategy

Below is my investment strategy for my clients and myself:

I wrote an article, *The Best Time to Invest.* Below is an excerpt from the article:

THE BEST TIME TO INVEST/BUY IS DURING THE BASING PERIOD, BEFORE THE START OF THE NEXT BULL MARKET WHEN STOCKS ARE UNDERVALUED. BASINGS ARE LIKE DIVING BOARDS, THE LONGER THE BASE, NORMALLY THE BETTER THE NEXT MOVE.

In other words, now is the time to start investing for the next bull market cycle. There is a lot of uncertainty, especially regarding the health crisis and it would be difficult for the economy to get off the ground if the virus is not controlled. The elections also create uncertainty.

1. I'm starting to invest now and want to be 50% invested before the elections.

2. After the elections, I want to be 100% invested, once we have a better understanding of any new economic policies.

3. If we do have a second wave of infections (hopefully we don't), then this will give me more time to assess the damage to the economy and markets. The markets could base longer giving us an opportunity to invest the other 50% at lower prices.

Summary and Conclusion

- The major markets have had a v-shaped rally based on: 1. A vaccine will be available by the end of year 2. The economy will reopen and there will be an economic v-shaped recovery. 3. President Trump will be re-elected.

By now we know we will not have a V-shaped economic recovery. The odds of the other two scenarios happening are questionable.

- If we pull back the onion of the market, there are many sectors in the markets that are in bear markets and are basing: banks, energy, airlines, hotels, entertainment, restaurants, retail… Some of the companies in these sectors will probably make it, some pay high dividends and some may make good long-term investments.

- We could have a double-dip recession and a retest of the March lows due to the following:

1. We get a second wave of infections in the upcoming cold and flu season
2. We get a new President in November
3. The markets adjust to a slower growth economy, with slower-growing earnings
4. If the 3 above scenarios happen, 401k investors and clients of financial planners may add to the selling.

- Investors should consider getting ready for the next bull market as many stocks are basing with high dividends.

- Personally and for my clients, I want to be invested 50% before the elections (just in case we do get a vaccine by the end of the year and President Trump is re-elected) and 50% after the elections (just in case we get a double-dip recession and a test of the March lows.)

I will provide my Economic Update next month. There are parts of the economy that are recovering.

The examples I provide are for - EDUCATIONAL PURPOSES ONLY AND ARE NOT BUY OR SELL RECOMMENDATIONS.

If you need help getting ready for the next economic and bull market cycle, feel free to contact me: danhassey@yahoo.com.