BERKSHIRE MONEY MANAGEMENT

The Knowledge and Experience to Build Your Wealth

January 11, 2018

THERE IS NOTHING TO FEAR

There is Nothing to Fear, but…

- Virtually every sentiment measure we look at is telling us to sell. But they have been whispering the same for over a year.
- The difference between market optimism and pessimism is at its largest level since April 1986, a year-and-a-half before Black Monday**.** This tells us that the stock market is at potentially dangerous overbought levels.
- Many investors are waiting for that one special moment to get invested into the market; that's a bad strategy.
- The first stock market pullback we get is going to be quick and impossible to time with any precision as it will refresh and reenergize the stock market for the first half of the year.

Berkshire Money Management made its (not so much) fame and (teeny tiny little) fortune by being contrarian. We sold when everyone else was buying, and we bought when everyone else was selling. This last year or so has been…different. Virtually every sentiment measure we look at has been screaming for us to sell equity and head for the hills. Or cash. Or bonds.

But instead, we've stayed invested and have reinvested deposits into the stock market (mostly via dollar-cost-averaging). I won't go into all the why's of why we abandoned our discipline, other than to suggest that investing is more of an art than a science. Still, I grew up on investing based on doing the opposite of the crowd. I am now part of the crowd. And that terrifies me.

One of my favorite sentiment metrics comes from Investors Intelligence. I'm not going to throw all the numbers at you, but let me give you the scary gist of it. The difference between market optimism and pessimism is at its largest level since April 1986, a year-and-a-half before Black Monday. To explain a bit, 64.4% of survey respondents expect the stock market to go higher. Only 13.5% expect the market to go lower. That hugely optimistic difference between the two is a contrarian signal that tells us the market is getting into dangerously overbought levels.

Investors have forgotten that the stock market goes down. In 2017 there were eight trading days when the market moved one percent (four were up, and four were down). In a typical year there are 75 such one percent days. The good news is that cash is waiting for an opportunity for the market to go down so that it can be invested into the stock market. Many investors are waiting for that special moment when the market goes down five or seven (or even three!) percent so that they can jump on the opportunity. In my opinion, that's a bad idea.

The first pullback we get is going to be shallow and it's going to be quick. Will you buy when it goes down three percent? Or seven? And if you don't invest now, will it go up before it goes down? And if you miss the pullback because you waited for a lower price, are you then forced to buy at a higher price?

I have said for decades that there are no tools that both consistently and reliably time the market. Even when we've gone to cash in big ways in the past, it was because of recession concerns, not because we wanted to be cute about timing the market. And we aren't going to try and be too cute right now about getting defensive.

I am not expecting much in the way of return for the market over the whole of 2018, but, also, I am not expecting anything more than the typical run-of-the-mill volatility (if you can remember what that is). But the good news is that 2018 started where 2017 left off. And it appears as if both stock market technical and fundamentals are strong enough to offset sentiment warnings for now.

You are all probably aware of the "First Five Days Barometer", a simple, yet popular technical tale that says if the first five trading days of a calendar year are up, then the gains of the rest of the year have historically been higher than if the first five days were down. It's not my favorite indicator. However, when the S&P 500 or the Dow Jones Industrial Average has been up at least two percent over those five days, as they were this year, the gains have been even stronger for the year

While the First Five Days Barometer is interesting, it is not one of the technical tools that keep me invested in equities. I won't go through them all, but, for example, the advance/decline line is at a record. That is encouraging because it measures the breadth of the market, meaning that there is strong support from company stock prices that comprise the market indices, as opposed to being lifted by narrowing number of name. Fundamentally, the market isn't as overvalued as many people purport it to be. There are still a lot of individual investors on the sideline. A market drop will be filled fairly quickly as valuations are not so stretched that they are a deterrent from buying, and investors still have cash to buy.

But, again, I do have concerns. Optimism is stretched. At some point out in the future, we're going to see another twenty percent drop. But whatever drop happens in the first half of 2018 will likely be too shallow and too quick to really take advantage of. I expect the biggest buying will not be as the market is down, but after a drop happens, as it becomes the pause that refreshes.

Bottom Line: I am not expecting much in the way of return for the market over the whole of 2018, but, also, I am not expecting anything more than the typical run-of-the-mill volatility (if you can remember what that is). But the good news is that 2018 started where 2017 left off. And it appears as if both stock market technical and fundamentals are strong enough to offset sentiment warnings for now.

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The Dow Jones Industrial Average (NYSE: DJI, also called the DJIA, Dow 30, INDP, or informally the Dow Jones or The Dow) is one of several stock market indices, created by nineteenth-century Wall Street Journal editor and Dow Jones & Company co-founder Charles Dow. The Dow average is computed from the stock prices of 30 of the largest and most widely held public companies in the United States. Clients of BMM may have portfolios that differ substantially from the composition of the DOW and therefore, their performance may vary significantly from that of the Dow. The Dow is used for illustrative purposes only, as one indicator of the overall US economy, and its past, present, or future performance should not be viewed as an indicator or comparison point for BMM client performance.

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For our affiliates' everyday business purposes— information about your transactions and experiences	NO	WE DO NOT SHARE
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For nonaffiliates to market to you	NO	WE DO NOT SHARE

Questions?	Call 888-232-6072 or go to www.berkshiremm.com

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