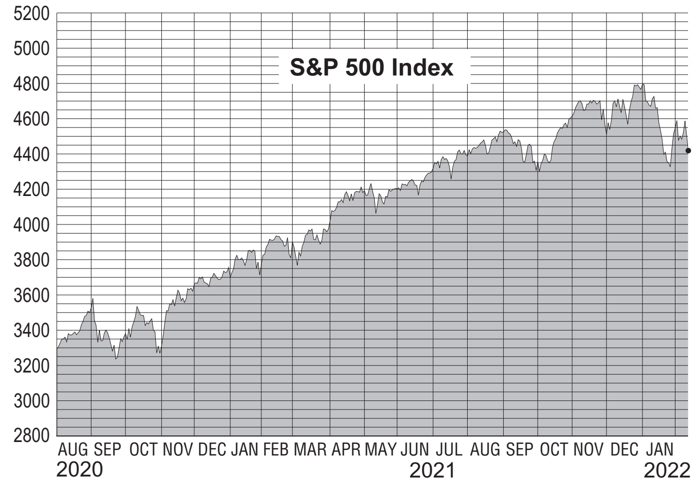
# InvesTech® Research

Vol22 Iss02 FEBRUARY 18, 2022


4 Weeks Ending February 11, 2022

| | High | Low | Last |
|---|---|---|---|
| Federal Funds | 0.08% | 0.08% | 0.08% |
| 30yr T-Bonds | 2.30% | 2.07% | 2.24% |
| Gold (London PM) | $1847.30 | $1788.15 | $1831.15 |

| | High | Low | Last | 200D M.A. |
|---|---|---|---|---|
| DJIA | 35911.81 | 34160.78 | 34738.06 | 35040.07 |
| DJUA | 955.23 | 922.87 | 924.77 | 918.70 |
| NASDAQ | 14893.75 | 13352.78 | 13791.15 | 14736.59 |
| S&P 500 | 4662.85 | 4326.51 | 4418.64 | 4452.06 |

S&P 500 P/E Current: 25.2 94 yr Avg: 17.5

## Technical and Monetary Investment Analysis

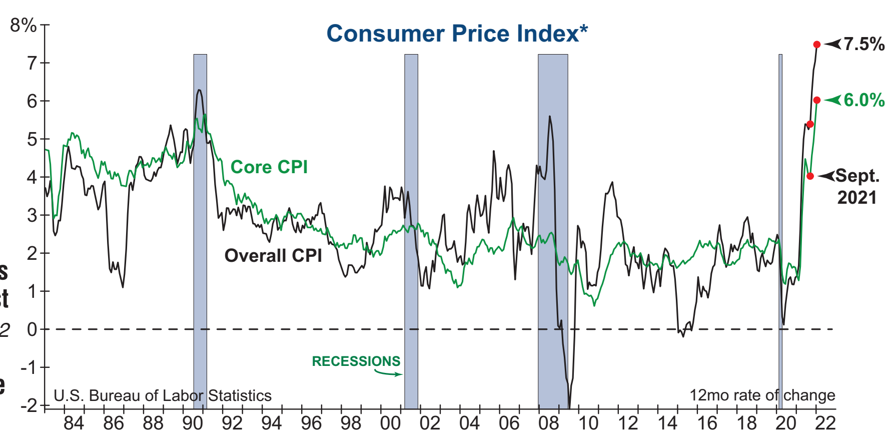
# On Collision Course with a Bear Market

As we've outlined in issues over the past year, the lofty levels of speculation and overvaluation, along with increasingly entrenched inflation pressures, make this a high risk stock market. The Federal Reserve is heading toward a monetary showdown, and inflation news isn't getting any better…

**US inflation highest in 40 years, with no letup in sight** – *ABC News, 2/10/22*

**Consumer confidence tumbles to 11-year low as inflation skyrockets** – *Fox Business, 2/11/22*

Just since last September, consumer prices have risen dramatically with the CPI hitting 7.5% and Core CPI (excluding food and energy) climbing to 6.0%. In our view, the odds are over 50/50 the Fed might hike a full ½-percentage point at their March 16 meeting – the first half-point rate hike since the peak of the 2000 Tech Bubble.




Yet this certainly hasn't tempered or dampened Wall Street cheerleaders…

**It's time to buy the dip as any further weakness in stocks is an opportunity to ride the upside through the rest of 2022, Goldman Sachs says** – *Business Insider, 1/26/22*

**JPMorgan Strategists See Sure-Fire Sign It's Time to Buy Stocks** – *Bloomberg, 2/8/22*

A comical anecdote today is that even those looking at 2022 market performance can't agree whether it's good or bad…

*Bloomberg – 1/30/22*
**Nasdaq 100 Notches Best Two-Day Rally Since 2020** ↔ *Forbes – 1/31/22*
**Stocks Just Had Their Worst Month Since March 2020**

Meanwhile, our own technical tools are sending a clear message. The InvesTech Canary Index has broken all support levels, and we'll prewarn you that when it and our Gorilla Index are overlaid on a similarly high-risk era of the past (inside), the road ahead looks treacherous. *But perhaps we're getting ahead of ourselves, as inside this issue we lay out the path of a [probable] bear market…*


EDITOR: JAMES B. STACK

625 Wisconsin Avenue ♦ Whitefish, MT 59937 ♦ (406) 862-7777
www.investech.com

## The Path of a [Probable] Bear Market

Historically speaking there are no bells rung at the start of a bear market. In fact, market tops are notoriously difficult to identify except in hindsight, as they are often quite volatile and take months to unfold. While all market cycles are different, this is when a sound knowledge of market history can prove invaluable.

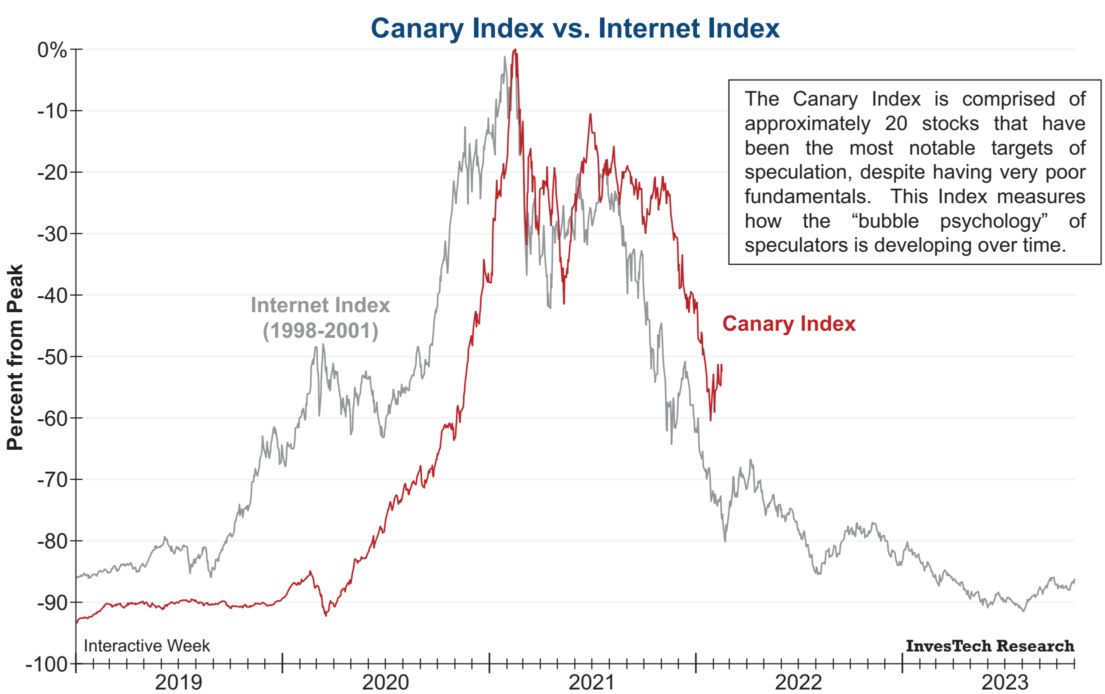
In recent issues, we laid out warning flags to watch – from the speculative frenzy to the mega-cap momentum stocks to internal leadership and all-important investor psychology. The good news is we've been preemptively defensive in our portfolio decisions. The bad news is those warning flags are starting to sequentially drop into place and resemble some of the most significant bull market tops in history.

## Speculators – Hot Money is Heading for the Exit

Major bear markets typically unwind in stages, with the areas of greatest excess falling first and often precipitously. Nothing has been more emblematic of this dynamic than the downfall of the Interactive Week Internet Index during the popping of the Tech Bubble in 2000. After the peak in the S&P 500 on March 24, 2000, the highly speculative Internet Index fell by -36% in six weeks – a strong signal that the speculative mania was starting to unwind.

In recent years, ultra-accommodative monetary policies from the Federal Reserve have led to a similar speculative frenzy. Our Canary (in the coal mine) Index is representative of the current speculative excesses, as it contains approximately 20 of the most overhyped, overbought, and overvalued stocks in the market over the past two years.

The graph below shows the surprising comparison between the Internet Index of the late 1990s and our Canary Index today. While the Canary Index has already lost more than half its value from the February 2021 high, the fact that the Internet Index ultimately lost over -90% suggests that the Canary Index stocks likely have further to fall.




Evidence that the speculative mania is waning extends beyond our Canary Index. A year ago, the speculative crowd became enamored with the ARK Innovation Fund (ARKK), sending it, and the new age growth companies it invests in, soaring to new highs. The meteoric rise of ARKK and its superstar fund manager attracted so much capital that it became the largest actively managed ETF seemingly overnight. Even so, the fund peaked soon thereafter and has lost -53% from its high as financial reality has gradually overwhelmed the speculative fervor.


Later in this issue, we present a dozen "fallen stars" that now have incredible losses after having previously been bid up into the stratosphere by eager investors. Some of these stocks are contained in our Canary Index, while others further highlight the loss of investor confidence that began a year ago in the most speculative issues. In all cases, these stocks demonstrate the importance of holding to a "safety-first" strategy and not getting caught up in the hype of speculative frenzies.

## Mega-Cap Momentum Stocks Are Losing Their Shine

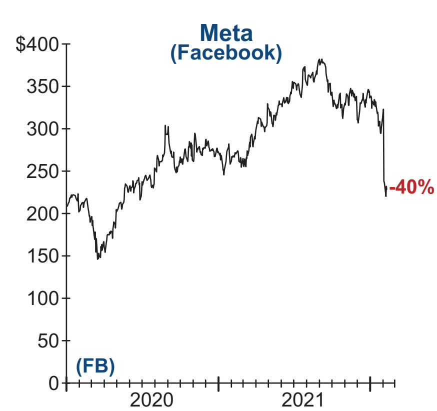
After the areas of greatest excess have started to unwind, the next bear market warning flag to watch for is a breakdown in the mega-cap momentum darlings of Wall Street.

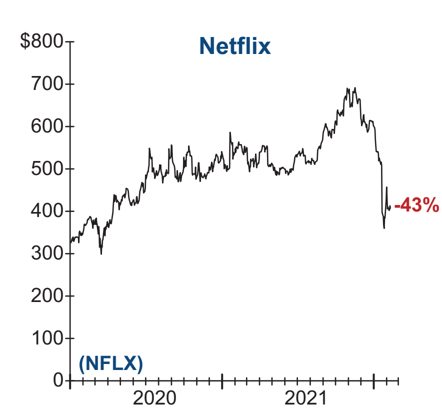
Stepping back to the Tech Bubble, we created our original Gorilla Index in 1998 when it became evident that a relatively small group of mega-cap momentum stocks were responsible for the majority of the market's advance. This Gorilla Index contained only 17 stocks, yet it accounted for a quarter of the S&P 500's market capitalization at the time. While the Gorilla Index held up relatively well for the first six months of the 2000-2002 bear market, it ultimately broke down, sending a message that major institutions were scrambling to raise liquidity and reduce market exposure.

Following the market rebound out of the COVID-19 Crash, we created the new InvesTech Gorilla Index, as an extremely narrow basket of mega-cap momentum stocks had once again become a dominant portion of the S&P 500. Today's Gorilla Index contains only ten stocks, yet it accounts for an even greater share of the S&P 500 (27%) than the original version.

The graph below shows the new Gorilla Index as compared to the original from 1998 to 2002. While we know that the underlying dynamics during both periods share similarities, it is truly staggering to see how closely their trajectories have aligned up to this point. The new Gorilla Index has been a bit quicker to unwind thus far (with a maximum drawdown of -20% from its peak) and is now near a critical support level. If today's Gorilla Index definitively breaks down, the S&P 500 will undoubtedly follow, and additional losses will lie ahead for this basket of mega-cap momentum stocks if we are indeed in a bear market.


Two stocks that show how much Wall Street has started to sour on these mega-cap momentum favorites are Meta (formerly known as Facebook) and Netflix. These stocks are components of our new Gorilla Index, and both have given back nearly all their post-pandemic gains—cratering by over -40% following less-than-optimistic earnings reports.

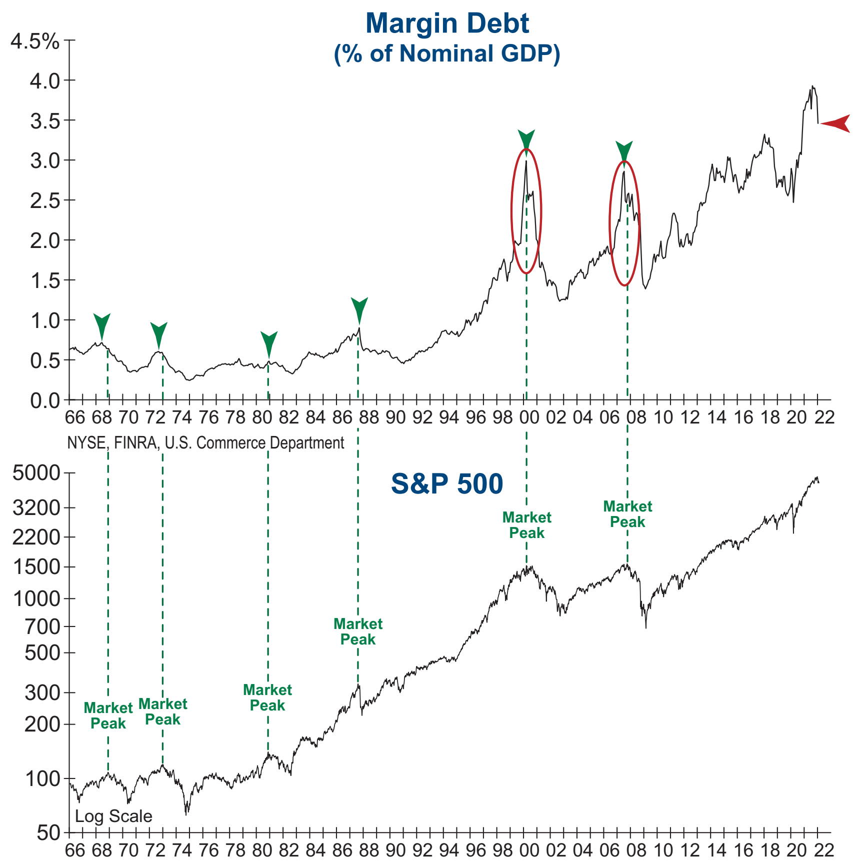



While there were reasons for the sell-offs, the degree and coincident timing of the selling pressure suggests that the psychological tide may be starting to turn for these once universally loved behemoths.

## Investor Psychology Is Taking a Turn

Margin debt is also confirming what the Canary and Gorilla Indexes are showing – that investor sentiment is starting to shift in a meaningful way. Margin debt represents the amount of money borrowed by investors to buy stocks on margin, which makes it a useful gauge of the public's appetite for leveraged risk-taking. Historically, peaks in margin debt tend to precede or coincide with peaks in the equity market as shown on the graph at right. Exponential increases in margin debt (ellipses on graph) have historically been indicative of excessive investor optimism and a high degree of market risk.



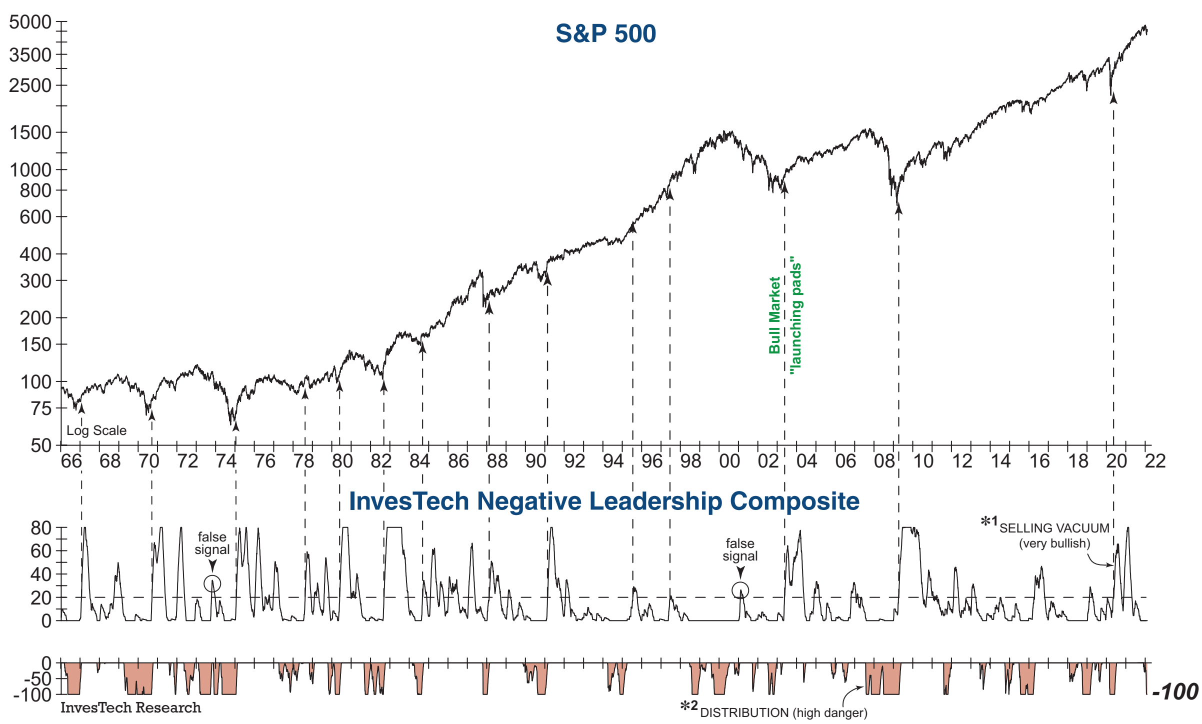

This week's release of the January data showed a sharp drop in margin debt to a level well below its recent high, representing a dramatic change in speculative psychology. While it's too early to definitively say whether this correction will turn into a bear market, it's clear from the recent drop in margin debt that this is a period of heightened risk.

The deterioration of investor sentiment today is enough to make any seasoned investor uneasy, yet the most worrisome technical signal is currently coming from our Negative Leadership Composite (NLC). First introduced in the *InvesTech Market Analyst* in 1989, the NLC measures downside market leadership, which can have either bullish or bearish implications.

When downside leadership dries up and a bullish "Selling Vacuum" [*1] develops, it typically marks the beginning of a new bull market or bull market leg. On the other hand, when downside leadership is accelerating and bearish "Distribution" [*2 – shaded region] emerges, it indicates that investors are increasingly willing to "bite the bullet" and sell stocks at a loss – something they're typically not compelled to do unless psychology has become acutely pessimistic. When Distribution falls to deeply negative readings, the stock market is particularly vulnerable, and that's when bear markets are more likely to strike. Currently, with Distribution locked at -100, it's clear that this is a high-risk market which should be approached with caution.

*1 SELLING VACUUM [-BULLISH-]: This confirms the absence of negative or downside leadership. It is normally a very bullish signal since a stock market without any downside leadership is destined to move much higher.

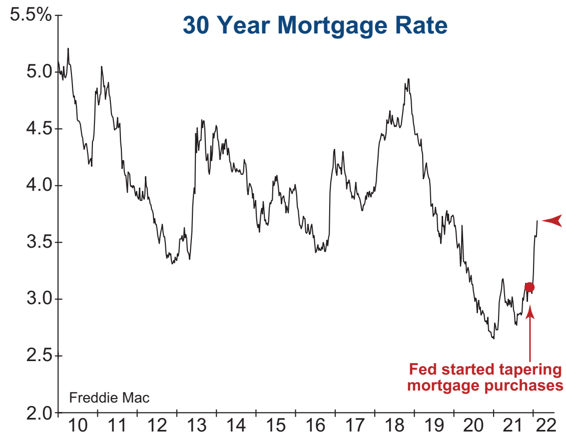
*2 DISTRIBUTION [-BEARISH-]: This signals that investors are anxious to sell stocks regardless of whether their position is at a loss, or the stock market is tumbling to new lows. It carries bearish implications as it suggests investors will use any rallies to get out of the market.



# Housing – The Next Shoe to Drop?

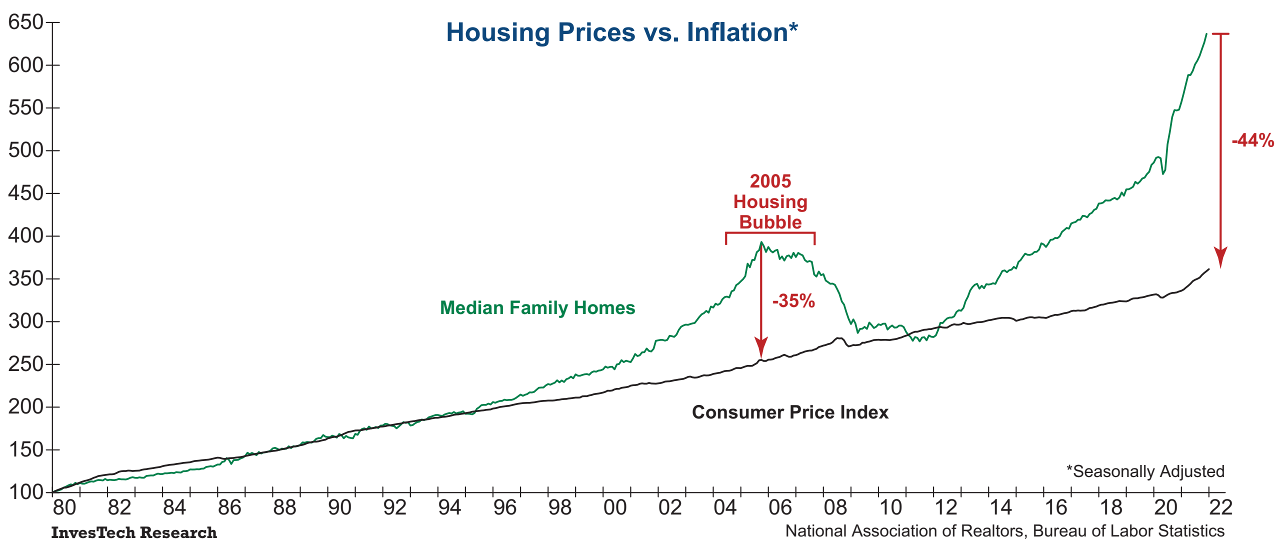
There is convincing evidence today that housing prices are in bubble territory. This carries strong implications for financial markets and the economy given the importance of housing to consumers' views of their personal balance sheets.

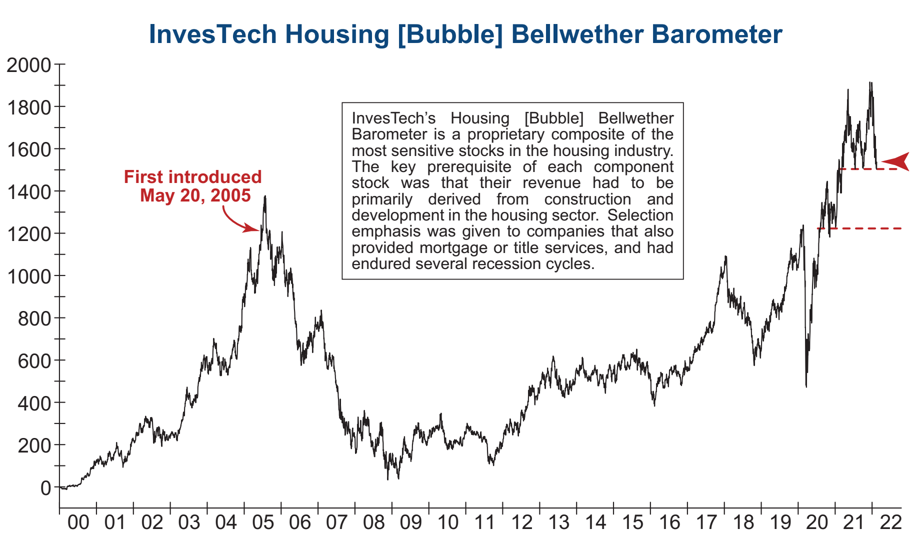
Unlike the 2005 Housing Bubble which was largely predicated on subprime lending and credit default risk, today's bubble has far more to do with affordability and interest rate risk. Mortgage rates have been suppressed over the past decade by the Federal Reserve's ultra-accommodative monetary policies, including direct purchases of trillions of dollars in mortgage-backed securities and near-zero interest rates.




As shown in the graph at left, mortgage rates dropped to a record low of 2.7% in early 2021 after the Fed threw the proverbial kitchen sink at the economy in response to the pandemic. However, the recent rise in long-term interest rates, along with the Fed's decision to taper their asset purchases, have caused mortgage rates to spike back to 3.7% – the highest level in nearly two years. The combination of rising rates and rising prices has made the average mortgage payment on the same property approximately <u>30% more expensive than just a year ago</u>.

The graph below shows just how far housing prices could conceivably fall after their unprecedented ascent in recent years. Specifically, housing prices would have to decline by -44% to return to the broader inflation trend line, which is even greater than the -35% dislocation at the peak of the 2005 Housing Bubble. Interest rates will no doubt play a central role in the timing and degree of normalization in housing prices, which is why the recent jump in mortgage rates in conjunction with runaway prices should not be ignored.



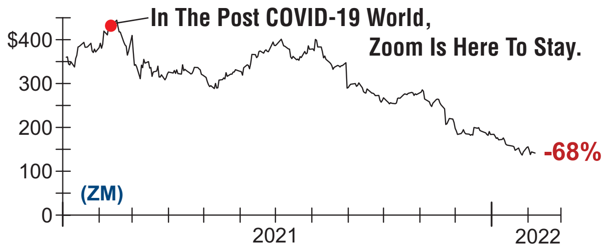




Monitoring the state of the housing market will be crucial in the months ahead as the Fed is due to begin tightening monetary policy. Our InvesTech Housing [Bubble] Bellwether Barometer was an important leading indicator in 2005, as it peaked just a few months before the top in housing prices. Today, this leading gauge is showing early signs of weakness, and a decisive drop through its support levels (red dashed lines on graph) would generate a significant bearish warning flag.

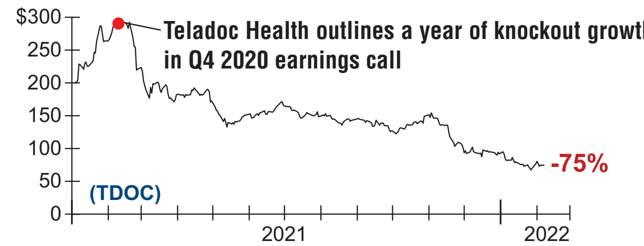
# Fallen Stars 2022

These are just a few of the more recognizable shooting stars that rode the speculative post-pandemic frenzy and have turned into fallen stars. When hype and headlines end, valuation starts to matter and eager participants' fear-of-missing-out (FOMO) is suddenly replaced by JOMO (the joy-of-missing-out) from those who prudently stayed on the sidelines...

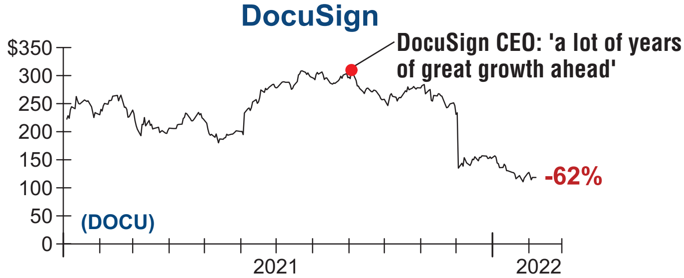
## Zoom



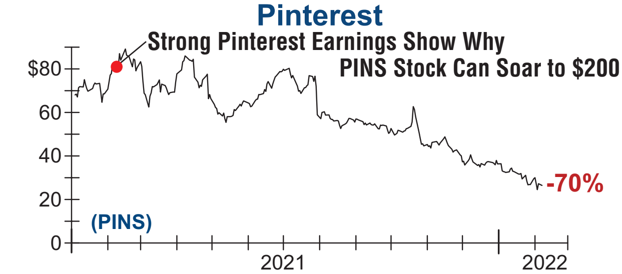

## Teladoc



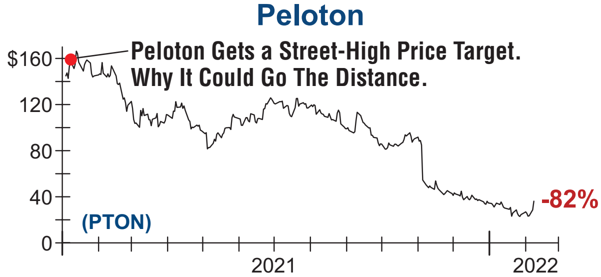

## DocuSign



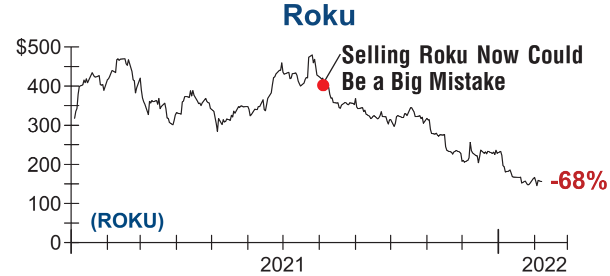

## Pinterest



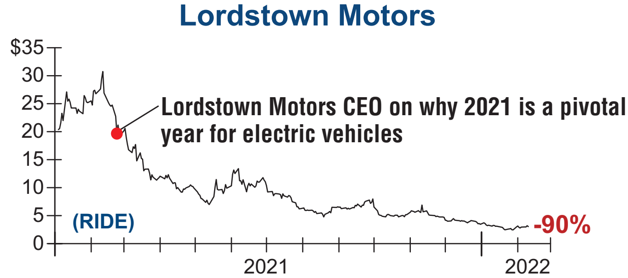

## Peloton



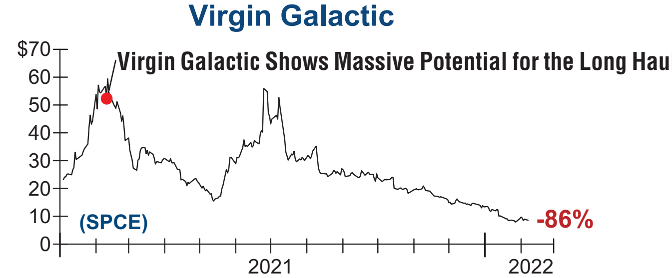

## Roku



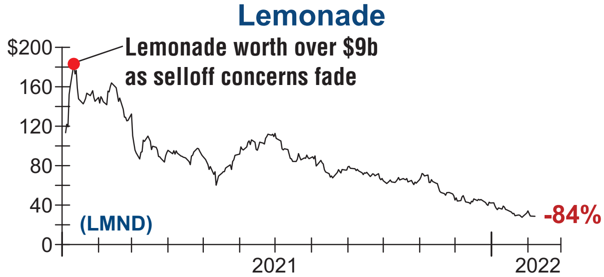

## Lordstown Motors



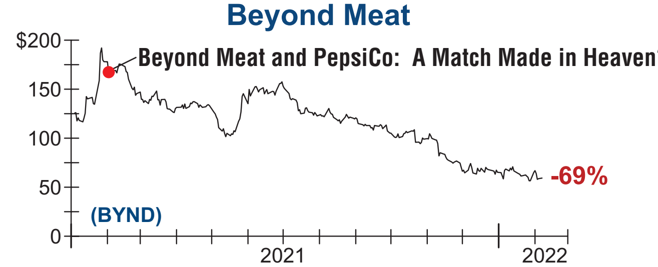

## Virgin Galactic



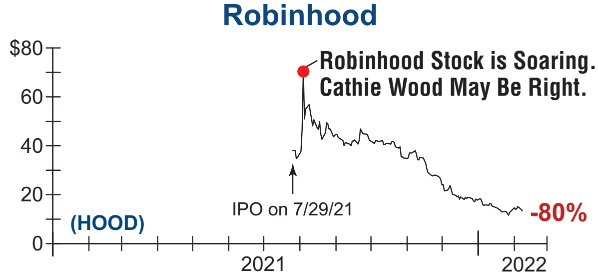

## Lemonade



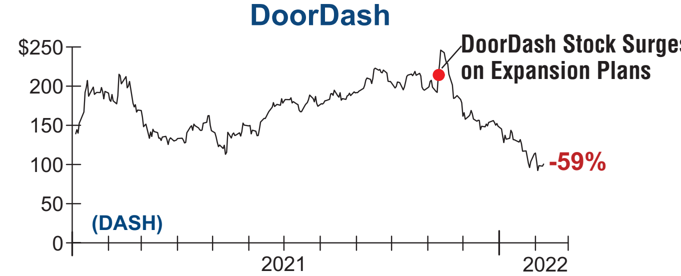

## Beyond Meat




## Robinhood

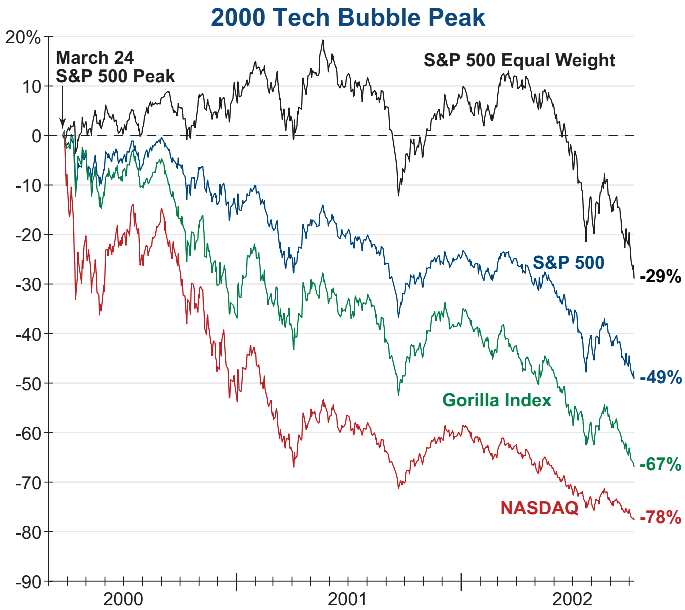



## DoorDash



# STRATEGY UPDATE

In introducing this issue, we intentionally injected the word 'probable' in describing *"the path of a [probable] bear market."* The reason is that evidence is clearly warning that an important top is likely in place; yet the jury is still out on whether this will be a protracted correction or a major bear market. However, we know that every bear market started out as a correction, and every big bear market started out as a small bear market. And that makes the next 60-90 days perhaps the most critical in this market cycle stretching back to its start in 2009 (COVID-19 Crash excluded).




As market historians, we know that all market cycles are different. But, when it comes to the messages being sent by our Canary and Gorilla Indexes (see pages 2-3), the similarities to the unwinding of the Tech Bubble are striking. If the end of this market cycle does take a similar path, the graph at left offers a few other valuable insights from the period…

Major bear markets like the Tech Bubble tend to unwind in stages marked by a sequential loss of confidence, rather than "popping," as is so popularly assumed. Preemptively avoiding the most speculative and overvalued areas of the market paid off handsomely as the NASDAQ and Gorilla Index fell harder and faster than the broad market (S&P 500). Perhaps most surprising, there actually were profitable places to invest through most of this infamous bear market, as shown by the resilience in the S&P 500 Equal Weight Index. Those who managed risk early were afforded time to adjust their portfolios as the evidence unfolded.

There is no crystal ball when it comes to navigating the eventual end of a market cycle. Rather, a disciplined assessment of the weight of the evidence allows you to proactively position your portfolio to be defensive when it really matters. Going forward, we are prepared to further increase portfolio defenses depending on how the indicators in this issue (among others) unfold.

In the end, navigating a [probable] bear market is not about putting your money under a mattress and waiting for the sky to fall. Instead, the focus should be on proactively managing risk to carefully navigate a wide range of outcomes and positioning oneself for that next great buying opportunity.

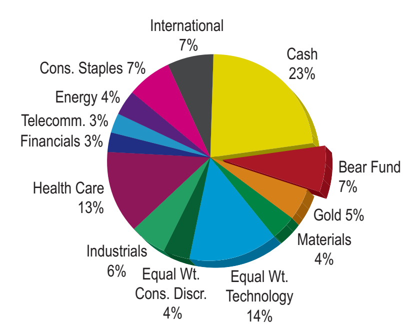
# MODEL FUND PORTFOLIO

*NEXT ISSUE: March 18, 2022*

**CHANGES SINCE THE LAST ISSUE: On the February 10 Special Hotline Update, we advised making the following changes:**

- **Exit the 3% position in the Communication Services Select Sector SPDR ETF (symbol: XLC).**
- **Reduce the allocation to the Invesco S&P 500 Equal-Weight Consumer Discretionary ETF (symbol: RCD) from 5% to 4%.**
- **Add 2% to the Direxion Daily S&P 500 Bear 1X ETF (symbol: SPDN) – which increases our total position in this inverse index fund to 7%.**

The Model Fund Portfolio currently has a net long exposure to the market of 63% (70% long positions plus 7% in an inverse index ETF). The remainder of the Portfolio (23%) is held in short-term Treasurys or a money market fund. Continue to monitor the Financial Hotline for important strategy updates.




| PERCENT | FUND | SYMBOL | 52-WEEK Hi | 52-WEEK Low | INIT. RECOMMENDED Date | INIT. RECOMMENDED Price | RECENT PRICE | ALTERNATE FUNDS |
|---|---|---|---|---|---|---|---|---|
| 23.0% | T-BILLS/ CASH/ MONEY MARKET | ---------- | | | | | | **Money Market Fund** |
| 7.0% | MSCI ACWI EX-U.S. SPDR | CWI | 30.37 | 27.67 | 2/25/21 | 28.20 | 28.64 | |
| 7.0% | CONS. STAPLES SELECT SECTOR SPDR | XLP | 77.62 | 61.74 | 7/1/11 | 23.70 | 75.25 | |
| 4.0% | ENERGY SELECT SECTOR SPDR | XLE | 70.41 | 42.06 | 7/1/11 | 54.77 | 70.41 | |
| 3.0% | FIDELITY SELECT TELECOMM PORTFOLIO | FSTCX | 64.99 | 53.80 | 9/18/20 | 54.79 | 56.12 | **Invesco S&P500 Eq Wt Comm(EWCO)** |
| 3.0% | FINANCIAL SELECT SECTOR SPDR | XLF | 41.42 | 30.66 | 6/8/12 | 7.60 | 40.11 | |
| 13.0% | HEALTH CARE SELECT SECTOR SPDR | XLV | 141.49 | 109.18 | 7/1/11 | 30.30 | 130.25 | |
| 6.0% | INDUSTRIAL SELECT SECTOR SPDR | XLI | 107.05 | 88.33 | 7/1/11 | 30.77 | 99.36 | |
| 4.0% | INVESCO S&P 500 EQUAL WEIGHT CONS DISC | RCD | 160.20 | 131.08 | 3/12/21 | 138.95 | 142.86 | |
| 14.0% | INVESCO S&P 500 EQUAL WEIGHT TECHNOLOGY | RYT | 327.55 | 249.72 | 9/18/20 | 204.40 | 286.93 | |
| 4.0% | MATERIALS SELECT SECTOR SPDR | XLB | 90.61 | 72.24 | 11/20/20 | 68.18 | 84.00 | |
| 5.0% | VANECK VECTORS GOLD MINERS | GDX | 39.00 | 28.41 | 9/29/17 | 22.00 | 32.43 | |
| 7.0% | DIREXION DAILY S&P 500 BEAR 1X | SPDN | 18.20 | 13.96 | 1/20/22 | 14.91 | 15.07 | |

## PERSONAL PERSPECTIVE

# *Follow the Evidence*

## *…the danger of the Internet and "selective analysis"…*

As we were pulling together the data from the countless candidates for our "Fallen Stars" segment of this issue, we stumbled across this tantalizing headline from almost exactly one year ago...

***5 Stocks That Can Double in a Biden Bull Market*** **– Feb 7, 2021**

Out of curiosity, we felt compelled to look up the 5 stocks and their resulting gains. Here they are:

Fastly (FSLY): –74.4% • Teledoc (TDOC): –74.1% • Cresco Labs (CRLBF): –47.8% • Ping Identity (PING): –38.4% • Redfin (RDFN): –63.1%

*Instead of doubling, they've been cut in half!*

For many investors, their portfolios are already in a sizable bear market. And for those who were overly aggressive like Cathie Wood's ARK Innovation ETF, the portfolio losses could easily exceed -50%. Yet if we are in the early stages of a bear market, there could be significantly more downside risk ahead.

**Here's what history says about stock-market returns during Fed rate-hike periods**

As it turns out, during so-called rate-hike periods, which we seem set to enter into as early as March, the market tends to perform strongly, not poorly.

In fact, during a Fed rate-hike period the average return for the Dow Jones Industrial Average is nearly 55%, that of the S&P 500 is a gain of 62.9% and the Nasdaq Composite has averaged a positive return of 102.7%.

*MarketWatch – 1/26/22*

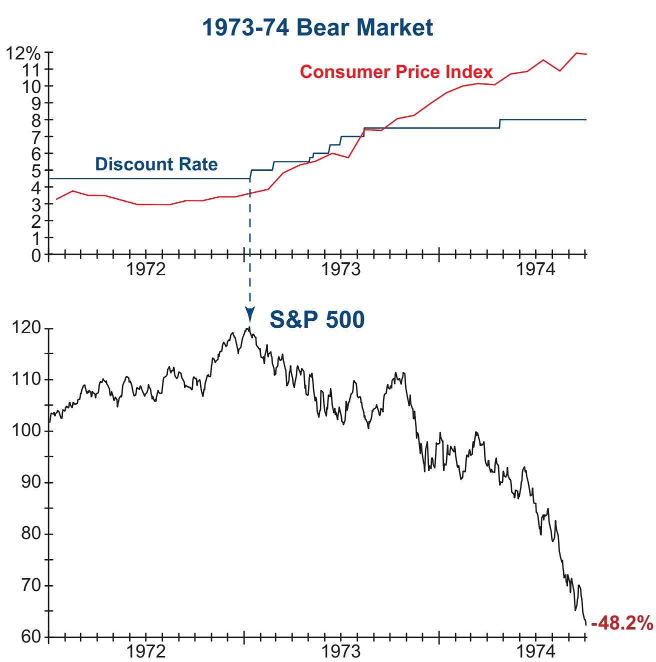
### The importance of being preemptive…

There are those who will argue that 1st rate hikes by the Federal Reserve are not that big a deal, and that it requires a lengthy sequence of rising rates to take a toll on Wall Street. In fact, selectively speaking, it could be argued that rising rates are <u>bullish</u> for Wall Street. →

My deep respect for the potential impact of monetary policy goes back to the 1970s and '80s at a time when inflation was seldom tamed, and one of the most respected analysts, Martin Zweig, invented the aphorism, *"Never fight the Fed."* Marty was also a panelist on the long-running TV program *Wall $treet Week* and became famous for his dire warning on the Friday broadcast before Black Monday in 1987. Marty and I became good friends through the Tech Bubble – and although we both erred too much on the side of caution, there was no better feeling than successfully surviving that severe bear market!

So when our research team looks back on history, we use our entire database and historical knowledge to ask, *"When have we seen this before, and what is the level of risk?"* And that's the problem with the above article about rate hikes – it only used data back to 1990. Inflation has never been this high in the past 30 years nor been rising so fast.

A valuable lesson is to look back at 1972, when the economy was hitting on all cylinders and inflation was starting to surge higher. The Federal Reserve announced its first interest rate hike on January 12, 1973... which turned out to be the exact day the big 1973-74 bear market started. So never say never when it comes to potential monetary impact on the stock market!




### Continue to follow the evidence…

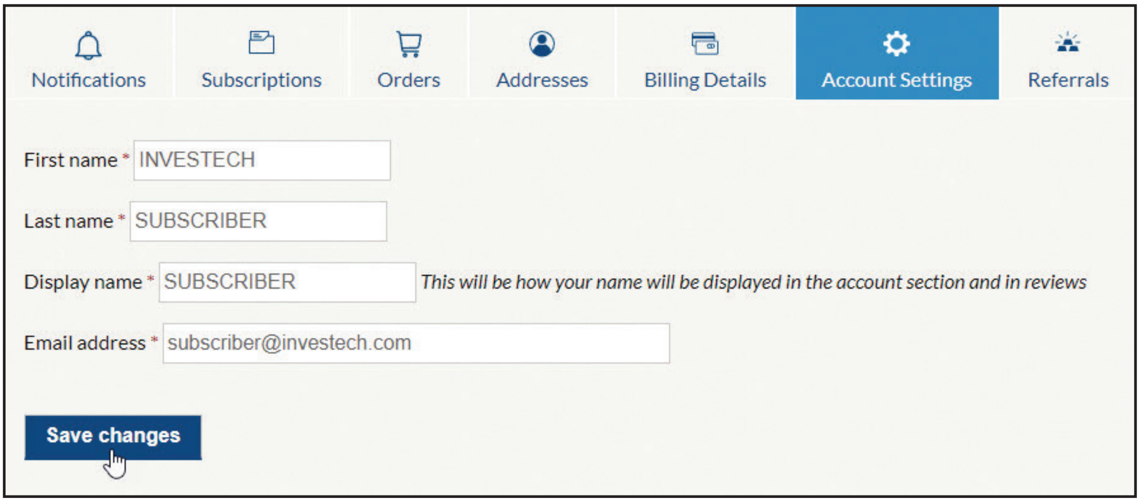
The sequential breakdown in key technical indicators has validated our move to an increasingly defensive position over the past year. Speculation has clearly peaked in many areas of the market (NFTs excluded 🙂), and the January top is looking like an important one. In other words – *Yes, this feels and looks like a bear market!*

Our *Strategy* inside this issue outlines the steps we will continue to take as evidence unfolds and additional bear market warning flags are triggered. The objective is not to abandon the market, but to proactively manage risk. We've been through these challenging market cycles before and are well positioned for the Fed's interest rate showdown ahead. Stay defensive, stay safe, and we'll help you stay alert as we prepare for a more volatile market ahead.

James B Stack

# InvesTech Research Email Alerts

With the increasing volatility in today's market, it's more important than ever that we have your current email address. To update your email address, send a request to investech@investech.com, call our office at (406) 862-7777, or enter the information on our website under "Account Settings" in the My Account area, found at https://www.investech.com/my-account/edit-account/




To ensure you receive email notifications from InvesTech, please add investech@investech.com to your email program's "Safe Sender List" or "Whitelist" and confirm emails from this address are not being blocked by your spam filter.

## InvesTech Sends Email Notifications:

☑ When a new monthly newsletter is published (on the 3rd Friday of the month).

☑ When a change is made to our Model Fund Portfolio.

## InvesTech Does Not Send Emails:

☑ When a new Weekly Hotline is posted (without a Model Fund Portfolio change). Weekly Hotlines are posted every Friday after 12:30pm ET.

☑ When a new Market Insight is posted. We recommend subscribers monitor this page regularly to keep up-to-date on the latest economic news and data releases.

## What to do if you aren't receiving our emails:

If you are not receiving our emails in your inbox, check your spam or junk folders, or the "Promotions" folder if you are a Gmail user. If you have checked these folders and still don't see our emails, please contact our office so we can help troubleshoot the problem. Call (406) 862-7777, Monday-Friday, 8:30am-5pm MT, or email us at investech@investech.com.