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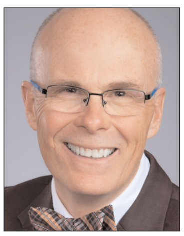
COMMON SENSE, THE LACK OF IT, AND AN OVER-CONCENTRATION OF 'CERTAIN NAMES'

Protect your portolio from overbought NASDAQ


Keith Richards

Once in a while, you have to toot your own horn. I've been in the investment business for more than 30 years, and have seen my share of up-and-down markets. And while it pays to remain humble in this business, there are times when I can smell a rat from a mile away. My last two columns for this publication have been warning you, the good readership, of the divergence between common sense and the over-concentration of certain names with huge influence on the U.S. and Canadian exchanges.

Go back to my last two columns to read my thoughts on the post-COVID hype. You'll see that I've been warning you of the probability of a correction, particularly within the NASDAQ. That warning seems to have been timely, at least at the time of writing this article near the end of September. Markets have been choppy since September began.

As I've noted in my last few columns, this has been one of the most (if not the most) narrow markets of all time. It's literally been about a dozen stocks within the 505 stocks making up the S&P 500, for example, that have done all the lifting.

The most crowded trades in the recent bull market have been:

-U.S. stock market in general;
-U.S. growth, in particular;
-U.S. dollars;
-U.S. Treasuries, and;
-Large-caps and tech giants.

The deflationary environment over the past decade helped all these trades. However, as the U.S. central bank continues to helicopter money, including the potential for the adoption of MMT (Modern Monetary Theory) and personal debt forgiveness if Biden gets elected, there is a genuine possibility (I think it's a probability!) for an inflationary environment.

MMT, here we come! Free money forever! I suggest that an inflationary environment would bring a much different outcome than the above U.S. market plays leading the charge in the future. I'm not alone.

"The next three-to-five years are going to be very, very challenging…for the first time in a long, long time I'm actually worried about inflation," says legendary investor Stanley Druckenmiller on the Fed. "I think we could easily see five per cent to 10 per cent inflation in the next four or five years."

How to protect your portfolio against inflation: Commodities like base metals and gold are typically the go-to plays to hedge against inflation.

Investors should consider some of the less popular commodities like agriculture plays as a good diversification against an overbought stock market. Also, keep an eye on oil for a setup (see top chart on page 419). It's got support at $35.

Technical short-term indicators are suggesting a bit more volatility ahead. However, longer-termed indicators are bullish.

At ValueTrend, we're not in oil yet, beyond one position in a pipeline. But we're watching. Meanwhile, we do have exposure to base metals and gold producers, and even an agriculture stock. Plus, some emerging markets who benefit from commodity price strength.

Mr. Druckenmiller, quoted above, is also concerned about the potential for a market bubble (in the U.S. markets):

"Right now, we're in an absolute raging mania. We've got commentators encouraging companies to do stock splits. Companies then go up 50 per cent, 30 per cent, 40 per cent on stock splits. That brings no value, but the stocks go up."

As noted in my last *Investors Digest of Canada* column, it's been lonely to be an investor concerned about market valuations, particularly the NASDAQ.

Everyone was wondering if the NASDAQ average would ever correct. Now that it is in correction, some investors suggest that it isn't a real correction. It's a blip. If market participants are in denial, that means they haven't capitulated. It's a high-risk move to buy in a correction without a capitulation. It can work out, but it's not the safest of bets.

I noted above that commodities are an interesting place to consider as an inflation hedge. As a bonus, they are also non-correlated to large-capped stocks. They march to their own drum. As noted above – that drum (inflation) may become louder over time, especially with the Fed announcing they no longer peg to a two per cent inflation rate.

Commodities are also a diversification away from an overbought equity market. Beyond gold, silver, and lumber (which are near-termed overbought) it's hard to suggest that most other commodities are overbought over longer time frames.

Look at copper, which has moved over the past month or two, but is still nowhere near its old highs. Oil is cheap, too. After all, the market is convinced that demand won't be picking up for that commodity. Everyone will own a Tesla. Perhaps now is the time to start thinking as a contrarian to the crowd.

Beyond commodities, keep an eye on international markets. Emerging markets are moving.

While we do have exposure to a broad EM ETF, we are also buying bits of individual EM country ETFs. The problem with the broad market play is the China-concentration. That's been fine so far. But its the other countries like Chile and Brazil that may offer better value, given their sensitivity to commodities. We own the Chile ETF, and continue to look for entry opportunities in a number of other country-specific ETF's.

Same goes for Europe. Sure, Brexit is back in the news. But where there is uncertainty, there also lies opportunity. We have a small exposure to a broad Europe ETF, and will look to add to it, or buy individual country ETF's over time.

Finally, there's value. I've been talking about value for some time in my *Investors Digest of Canada* columns. The bottom chart on this page is for the U.S. Value index, **iShares Morningstar Large-Cap Value ETF** (JKF-NYSE/Arca, US$98.11). Notice the nice progressive base move, with no overbought parabolic silliness built into this chart.

There's also the Canadian value side, as reflected in the **iShares Canadian Value Index ETF** (XCV-TSX, $21.75).

There's not a lot of depth here in the Canadian stock picking world, so this ETF is somewhat focused on banks and insurance. Still, that does appear to be a cheap part of the market.

Canadian dividend stocks are also looking cheap. The trajectory of the **iShares Canadian Select Dividend Index ETF** (XDV-TSX, $21.75) illustrates that.

The above charts are illustrations of the concepts of where we are looking. We don't own any of those ETF's and don't necessarily endorse them. However, they are good starting places to consider.

At ValueTrend, we like buying a few ETF's – particularly when it comes to international themes or near-termed sector trading strategies (also known as seasonal swaps, broad sector thesis trades like gold, etc.). But when it comes to home soil, we tend to focus more on individual stock selection.

As such, if you like the look of any of the above charts, consider going to the company website and getting a breakdown of the holdings. There, you may find an excellent shopping list of individual names that may outperform the group.

As you may know, an ETF is just a mixture of the good, the bad, and the ugly within a stock sector or mandate. It's often best to buy the individual names if you are thinking about your holdings beyond a near-termed trade.

Stay focused and be the contrarian in this overhyped market. Hold some cash! Money is always looking for a home, it does not remain stagnant. Be sure that your portfolio is positioned to be that home.

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