Bear-o-meter continues to read bullish, in spite of it all...

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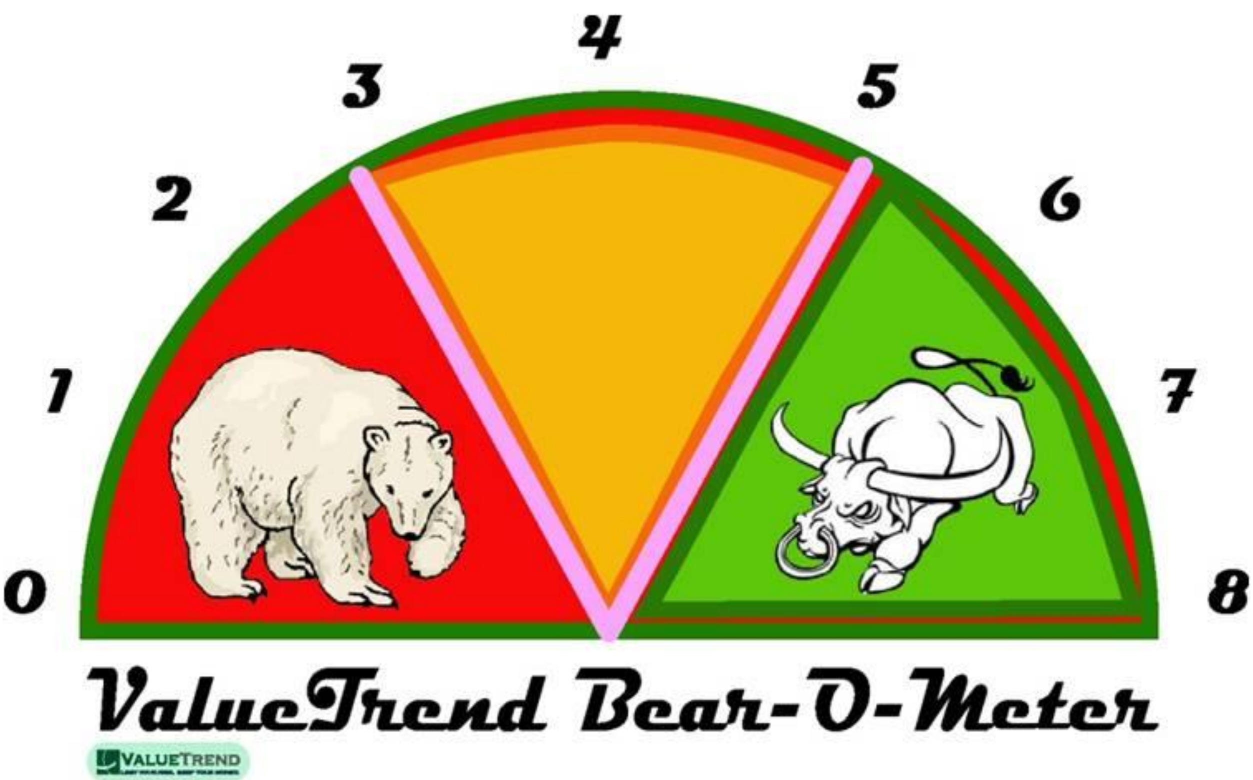
Regular readers of this blog are familiar with the monthly reading of my risk/reward matrix known as the “Bear-o-meter”. The Bear-o-meter is a compilation of 11 indicators broadly placed within 5 categories. Each of the 11 indicators gets points – whether positive, negative or neutral – towards an ultimate risk/reward profile of the S&P 500 index.

The 5 categories I look at are, in my opinion, the most important things to know insofar as market risk is concerned. They are not going to tell us what to buy, nor will they tell us precisely when to buy or sell. Instead, the Bear-o-meter provides insight when viewing market “health” from a mid termed (weeks to months) outlook. It weighs the relative risk/reward of the market on a scale of 0-8, where “0” is very high relative risk, and “8” is very low relative risk.



The 5 categories are :

- Trend

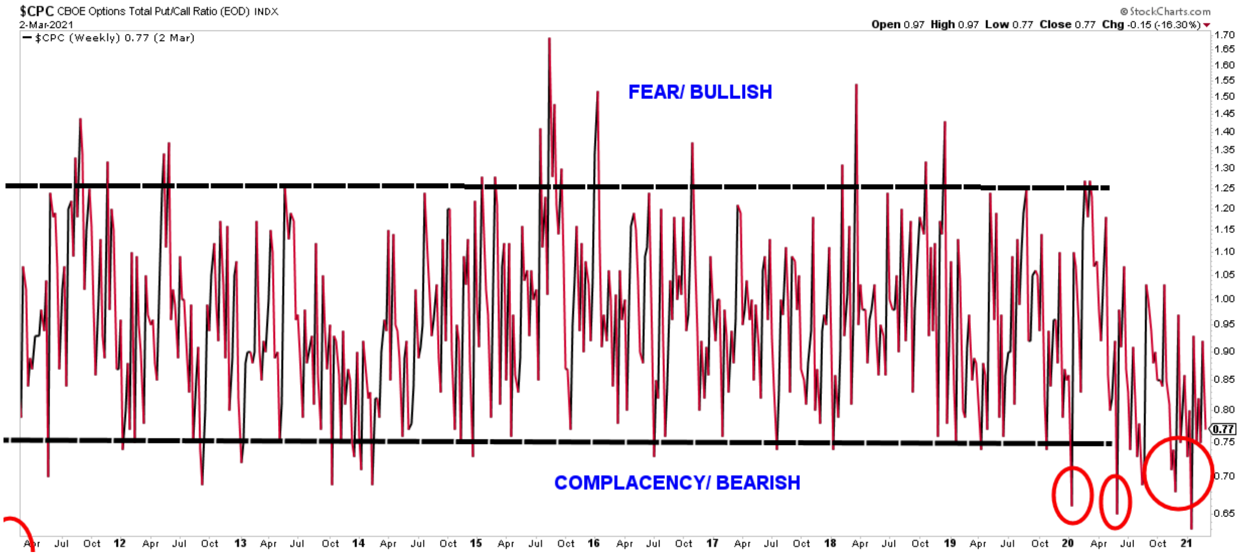
- Breadth
- Valuation
- Breadth-momentum
- Sentiment

Last month, the Bear-o-meter read a very healthy 6. This, despite some overbought sentiment signals urging caution. The month of February turned out to be OK, suggesting the lower risk indications presented by the Bear-o-meter was merited.

The more things change, the more they stay the same. This month, we pretty much have the same situation. That is, healthy trend, healthy breadth and positive seasonal factors providing lots of positive points. In fact, the meter lost only one point to the Smart/Dumb money. Dumb (retail) money continues to love this market, while smart (institutional players) aren't so enthusiastic. Note how deep the smart/dumb line is below the "danger zone". The Bear-o-meter remains at 6 as of March 3rd 2021.

Somebody asked me about the efficiency of the Smart/Dumb money indicator going forward, given the new influence seen by small retail investors through social media platform trading groups. [This video] covered the topic. My answer to that question was that – yes, in the near-term, there is a changed dynamic within the Smart/Dumb influence. I recently interviewed Sentimentrader's Jason Goepfert for my upcoming book on contrarian trading, and that question came up. In a nutshell, Jason wonders if its just a moment in time, rather than the beginning of a new paradigm where retail controls the market. I might add that smart money (hedge fund managers, pension managers, commercial hedgers, etc.) didn't become rich by being dumb. They are aptly named smart money for a reason. My own view is that the smartest guys in the room will ALWAYS figure out a way to profit from the dumb money, even if there is a temporary interruption.

The other indicator that was on the verge of losing a point in the Bear-o-meter complication is the Put/Call ratio. Note on the chart below that it sits marginally ahead of my 0.75 puts/ 1 call trigger for a negative score. Note on the chart that this indicator has been consistently toying with a low reading – it really hasn't returned to a mid-level for some time. Thus, despite that marginally neutral score added to the Bear-o-meter, the Put/Call ratio is telling us that market participants are becoming irrationally exuberant.



Conclusion

Sentiment indicators suggest that markets are frothy, but the trend is the trend. My thoughts are for a [bit of volatility](), which would help wash out these rather fast-moving indicators from their current danger)or near-danger) levels. If not, then we might see much more damage as the summer comes. For now, its a momentum market, and the tape should be respected. Be sure to check out the ValueTrend update newsletter, which was sent to your email yesterday if you are a subscriber. In it, I note the pattern of month-end selloffs – and how to take advantage of that tendency.

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Comments are always welcome…below!

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