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Bear-o-meter tipping between high risk and neutral

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Every month, I record the reading of my "Bear-o-meter" risk/reward model for the US markets. This model attempts to compare the relative tradeoff between the two (risk vs reward) via an easy to understand numerical reading. A low reading suggests a relatively less opportunistic environment, while a high reading suggests a highly opportune environment. The model incorporates the following factors: Trend, Value, Breadth, Breadth/Momentum, Sentiment, Seasonality.

Keep in mind that this compilation measures a relationship to the RISK you will be taking on to invest in the market when compared to the potential for opportunity. As such, a momentum-based market environment that is throwing caution to the wind can create tons of opportunity, despite the risks. As a 31 year veteran of this industry, I can recall a few such periods – including the very late 1990's (tech bubble), 2007 (oil and subprime bubble) and 2017 (President Trump's inaugural year). In all three of those occasions, risk presented itself as higher than normal via most of the sentiment indicators and breadth indicators I watch. But momentum overshadowed that risk. It should be noted that the risk was eventually realized via market crashes in the first two examples (2001, 2008 crashes). The market staged a correction (not a crash) in late 2018 after the hyper risk readings during 2017.

I point this out because when we see a high risk reading on the Bear-o-meter as we saw last month, it doesn't imply an automatic correction.

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In my last blog, I noted that we saw a similar high risk reading on the indicator in August 2020. What I didn't mention was that the market rallied for about a month before we saw any weakness. Above is a chart with the signal in 2020. Note the strong (10%) rally that followed the high risk reading. Hey, what gives? It was so utterly wrong! But wait… observe the weakness on the SPX after the September peak, and on. And observe the big swings after that September peak, until November of that year. Obviously, market risk does not imply a market timing opportunity as much as a heads up to keep your eyes on the tehnical developments of the market.

Right now, given the high risk reading of last month (June) and the subsequent rally… it kinda looks like the pattern after the June 2021 alert, doesn't it? That's why I am keeping my eye on the charts for possible deterioration. And, I'm holding some cash- although not aggressively so. One of the tradeoffs with a risk-orientated trading system is that we will temporarily underperform a surging market when our system flashes risk. This happened in August 2020 (until we were rewarded for our cash and sector rotation). Right now, our 15% cash is causing a slight underperformance (although still quite good – click here for results) as the market surges. But, a system is not a system unless you follow it. History has shown us that its best not to argue with the Bear-o-meter – it often proves correct, if not with pinpoint timing.

Bear-o-meter reading for July 5, 2021

Ok, enough banter – lets get to it. **The current Bear-o-meter reading has moved up from "2" (high risk) to "3"**. That level, as seen on the diagram below, rests right on the line between high risk and neutral. So…you choose. Do you want to call it high risk or neutral? I'll call it tentatively-neutral.

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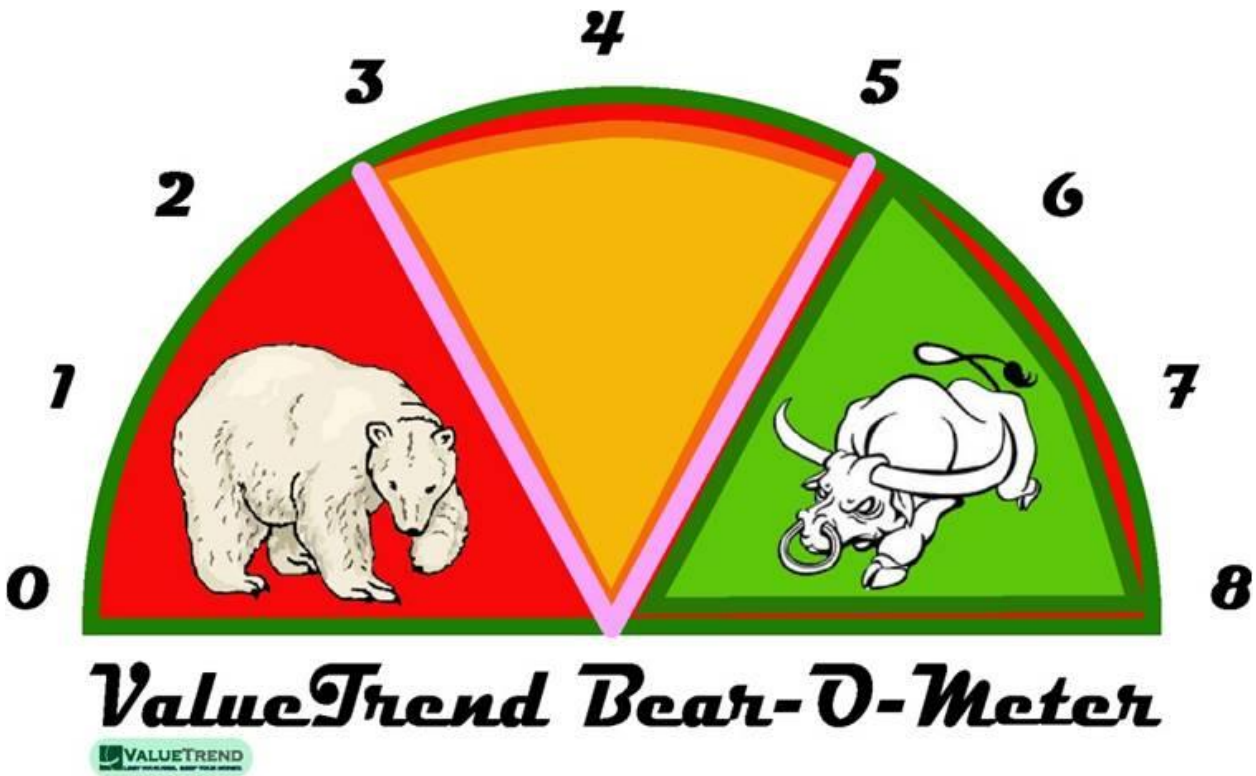

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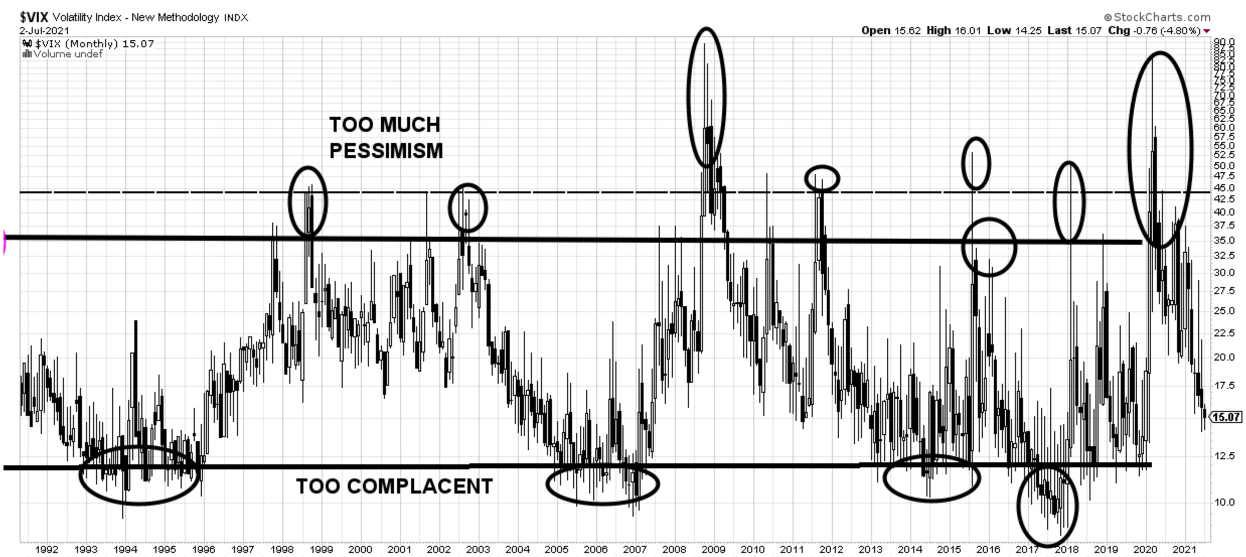
Here's what happened to add one point to the Bear-o-meter:

- The New High/New Low breadth momentum reading went to neutral, adding a point after its negative reading last month
- The Put/Call indicator went to neutral after last months negative reading as well, adding another point
- The Smart/Dumb money compilation moved down into its risk zone, subtracting a point

Of interest, the options-based sentiment indicators in the Bear-o-meter (VIX and Put/Call ratio- noted above) are both neutral. But barely. A bit more optimism by market players would push both of these indicators into bearish (complacency) zones. And that would shove the relative risk reading right back into bearish. Given how close they are to that vital "risk" reading – I'd keep an eye open. It might also be noted that markets are typically bullish for the first two weeks of July before taking a rest in the second half and onward. I made note of that in my latest video – which should be posted here by tonight (Monday July 5th). On the video, I presented a possible sector trading opportunity based on some seasonal patterns. Watch for the video ***"Is this the next sector rotational opportunity?"*** to be posted later today.

Here is the chart of the VIX -note how close the reading is to my high-risk zone of 12 (current reading is 15).



Here is the chart of the CBOE Put/Call ratio – note how close the reading is to my high-risk zone of 0.78 (risk zone falls below 0.75).

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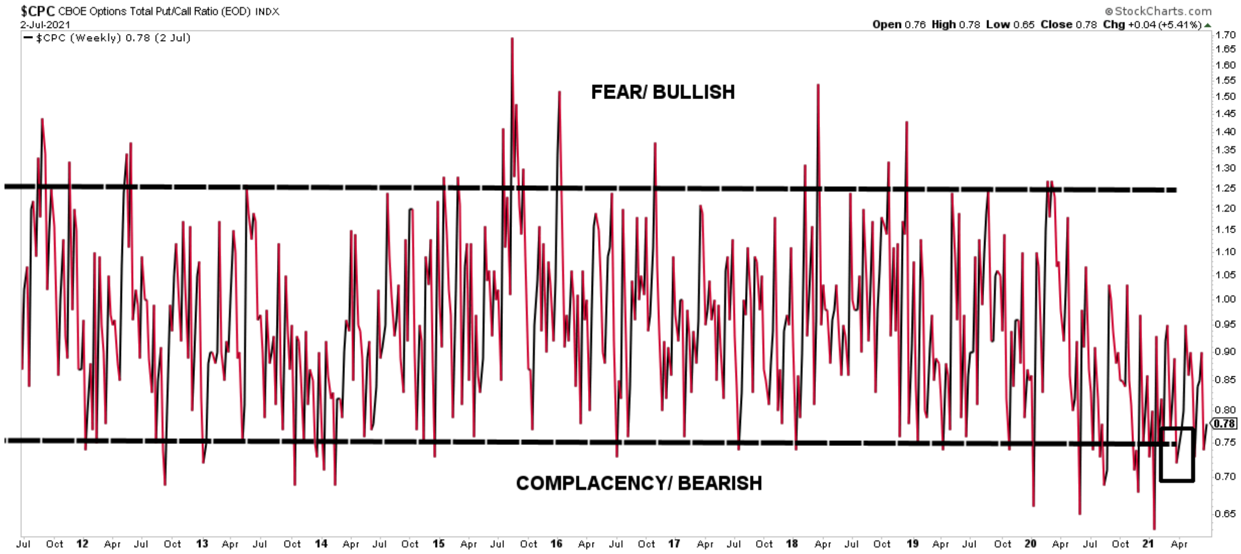

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