For the first time in 8 months Bear-o-meter signals high risk

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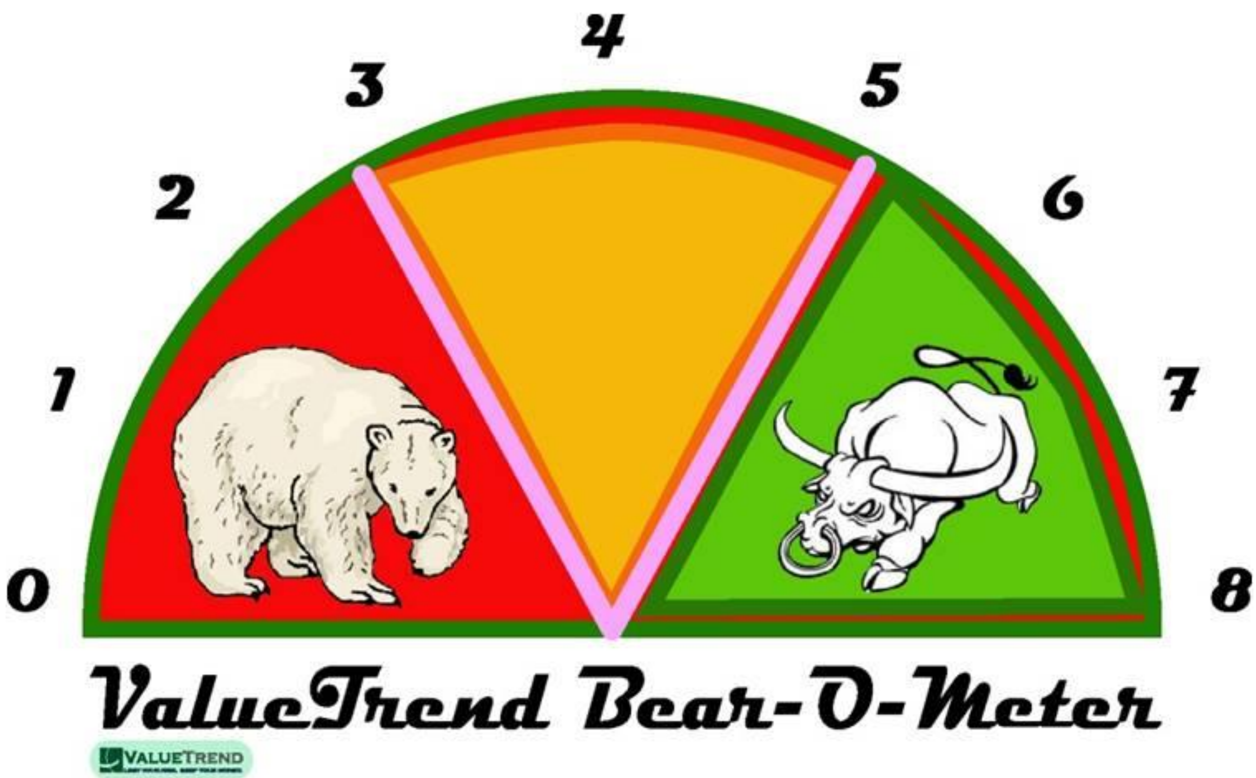
Long time readers of this blog know that I report on the relative risk/reward tradeoff on US markets at the beginning of each month via my Bear-o-meter compilation. This simple to understand indicator combines 11 factors that I have been using over many years of my career. I use it to understand the current tradeoff between potential upside vs. downside on the market. The Bear-o-meter presents a scale of 0-8, where 0 is high risk relative to return potential, and 8 is low risk relative to return potential.



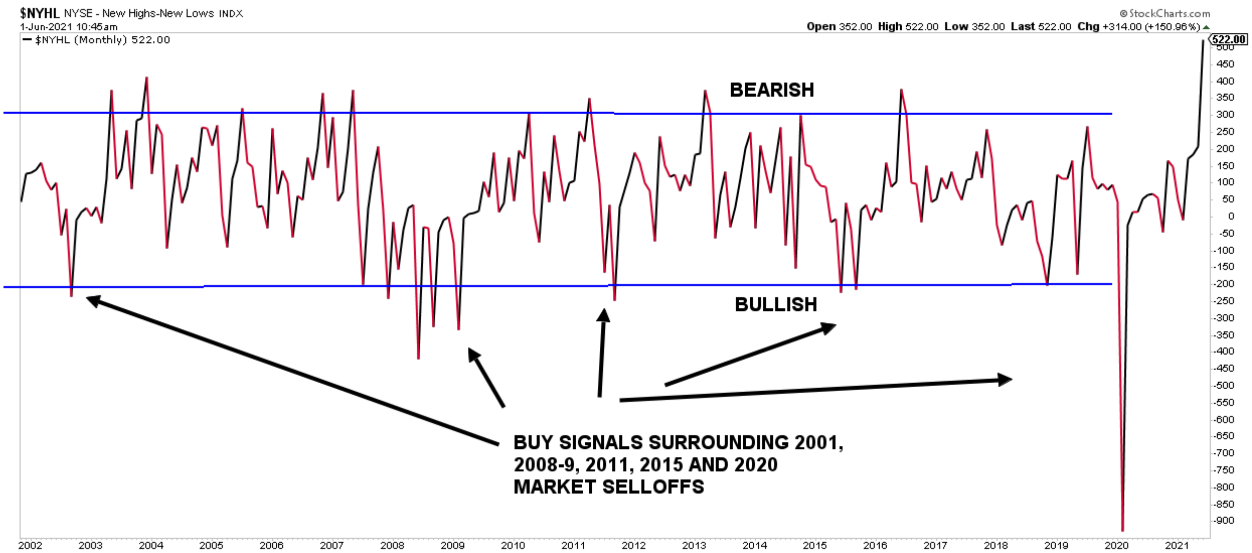
As I always point out – markets present BOTH upside potential AND downside risk at ALL TIMES. Under normal conditions, the Bear-o-meter reads somewhere in the middle of that tradeoff- which is illustrated in that scale via a reading between 3-5. However, that tradeoff can be skewed towards one side of the equation or the other at times. We can measure that tradeoff by looking at the markets trend, its breadth, its valuations, current seasonal influences, and market risk appetite. To put it simply, an overbought, overvalued, over-optimistic market is more risky – and that risk is illustrated via a reading of 0-2 on the Bear-o-meter. An oversold, undervalued, pessimistic market presents a less risky investment climate, which can be numerically illustrated on the Bear-o-meter as a reading of 6-8. Again, those conditions are considered extreme, against the typical balanced market of risk/reward conditions.

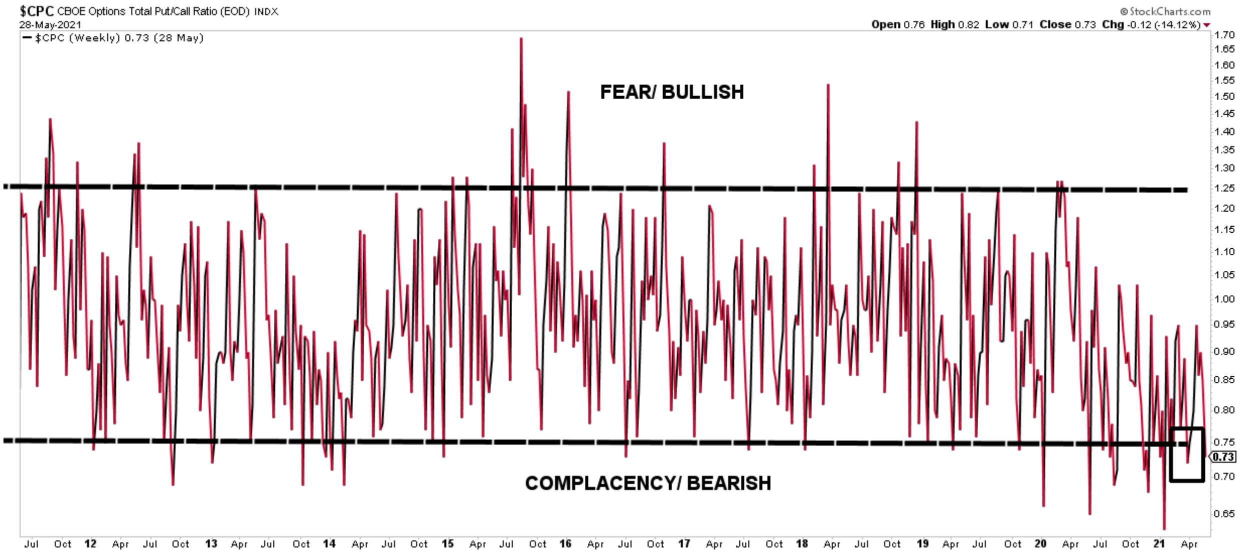
The Bear-o-meter just signaled its first high-risk reading since August of 2020. It should be pointed out that the Bear-o-meter was quite accurate regarding its risk assessment that month. Turn the clock back, if you will, and recall the concentrated (narrow) breadth of the market at that time. Investors focused on just a dozen or so “stay-inside” and technology/ FAANG names. The Bear-o-meter was dead-on with its high risk assessment of “2”. The SPX was near 3600 at the time of the reading. It fell to 3400, and did not surpass 3600 until 3 months later in late November. The NASDAQ followed the same pattern, moving drastically more – from 12,000 down to 10,500 – and not recovering until late November.

Even more significant was the near-perfect low-risk reading the first few days of November (reported Nov. 2nd on this blog) when the SPX was right at the bottom of its trading range near 3400.

This backdrop brings us to today. As of June 2nd, 2021, the Bear-o-meter is presenting a high-risk reading of “2” – similar to the reading seen in August of 2020. In fact, the Bear-o-meter has been declining one point a month since March of this year, when its last reading of a “bullish” 6 was taken. To me, this means one thing: raise cash and lower beta. A high risk reading on the Bear-o-meter does not imply that the market cannot rise from here. It does imply that the market is presenting far greater risk than it has in while. While it is true that “Trend Trumps All” – it is also true that the greatest truism proclaimed by John Templeton was to “Buy when others are despondently selling, and sell when others are greedily buying”

The big changes we have witnessed on the Bear-o-meter fall into the investor sentiment and breadth momentum readings. Effectively, this means that investors are overconfident, and markets have expanded on that confidence too quickly. Templeton’s suggestion of “selling when others are greedily buying” is ringing in my ears when I look at the indicators making up breadth momentum and investor confidence in the Bear-o-meter. Below are two of the indicators I am looking at. Note their relative levels to where I mark the “risk” levels. They are: the Put/Call ratio sentiment reading, and the New High/New Low breadth momentum reading. It might be noted that the New high/low indicator is sitting at the highest level I have on my records – certainly above anything seen in the last 20 years (chart below, note the spike on the right side of the chart).





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