Bear-o-meter goes bullish

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The Bear-o-meter is a risk/reward measurement tool that I've been using since 2013. It's a compilation of indicators falling under general classifications of:

- Breadth
- Value
- Trend
- Breadth momentum
- Sentiment
- Seasonality

As many of my regular readers know, the Bear-o-meter assigns risk on a scale of 0-8. A reading of 3 or under is generally a higher risk market. A reading of 3-5 is about "average" for a risk/reward tradeoff. Anything 5+ is considered lower than average risk. The illustration below shows us that a rating of 3, or 5, is kind of borderline. As I have noted in the past, this scale measures potential risk vs. potential reward. A low risk reading (above 5) doesn't mean there is no market risk. A higher risk reading (below 3) doesn't imply that doom is immanent. Both risk and reward are present on the market at all times. Its the relative degree of that risk that is important. We adjust our cash holdings and the beta of our securities with the risk displayed by the Bear-o-meter.

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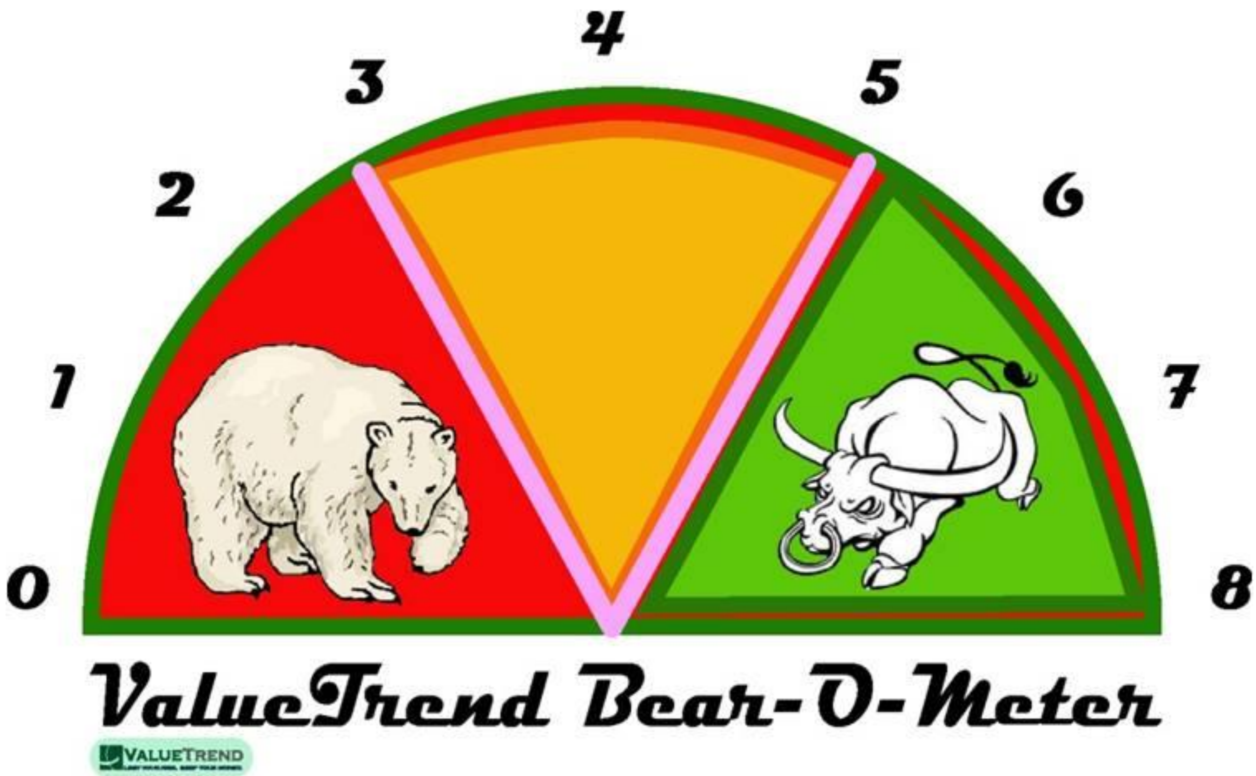
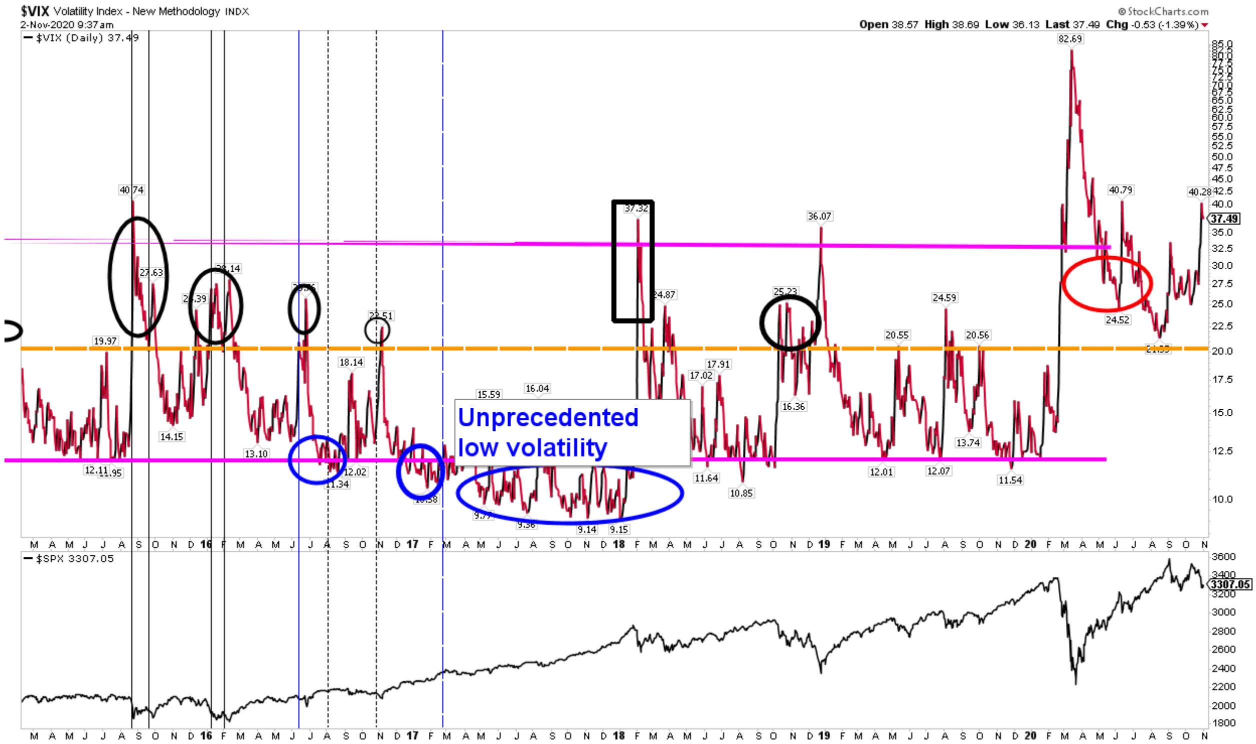


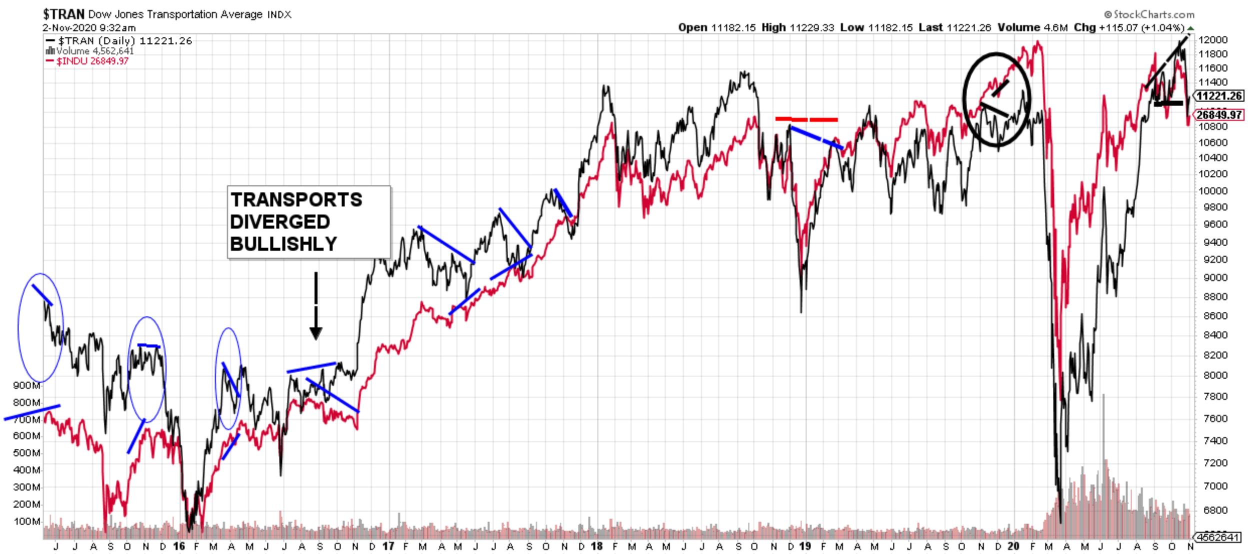
Last month, the Bear-o-meter read “3”. That’s a higher risk reading. To quote myself in the October Bear-o-meter blog: “This might suggest more volatility ahead.” Interestingly, the reading was also “3” in September, and that month was also volatile. These readings were useful in steering us towards holding a bit more cash. As such, we dampened a significant amount of the volatility over the past two months. I hope some of you find my monthly readings of this indicator helpful in your own investment strategy.

This month, the Bear-o-meter reads a very bullish “6”.

The 3 points that moved the needle from bearish to bullish were seasonality (which adds 2 points every November, then goes back to a “0” score from May to November) and a positive move by the VIX. The VIX chart below shows us that volatility reached a level where my research suggests the market has become overly pessimistic. Its a contrarian indicator, so high pessimism is a bullish factor. I noted on this blog that I traded the VIX in the ValueTrend Aggressive Growth Strategy -buying a VIX ETF when the VIX had declined in early October then selling it last week. Here’s the VIX chart.



Another positive for the markets comes out of the old Dow Theory tenant that looks for confirmation between the TRAN and INDU. I tend to look for trend divergences in my own twist on this concept. The chart below illustrates my historic annotations between these trends. Note that such divergences are pretty good at timing pullbacks when the TRAN (black) line divergences negatively against INDU (red line). I assign a negative point when that happens. Although it doesn't add a positive point to the Bear-o-meter, I did note a positive divergence between the Dow Transports – which have seen a rising peak lately, vs the Industrials, which were more or less flat (actually, a slightly lower peak in October vs the summer). The chart below illustrates that this is rare. It happened in 2016. This spurred on a strong bull market in both indices in 2017. So the transports can be a leading indicator, and right now they suggest a positive move going forward.



The rest of the factors were identical from October. The smart/dumb money indicator remains in bearish territory, although I must point out that the indictor is moving higher towards a positive reading.

Conclusion

There may be some shake, rattle and roll over the next week or so as election jitters hit the markets. But its looking pretty bullish from a quantitative risk/reward perspective at this time. We bought a couple of stocks on Friday's test of 3200 support – noted on this blog. We are still sitting on 26% cash in the Equity Platform at this time. My intention is to be fully invested in the coming week or two, assuming some sort of clarity concerning the US election. The stage is set for a bullish winter.

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