



Our Weekly Paid Newsletter

# Richard Cluver Predicts

In our 34th year of service to the investing public of South Africa



Volume: 34

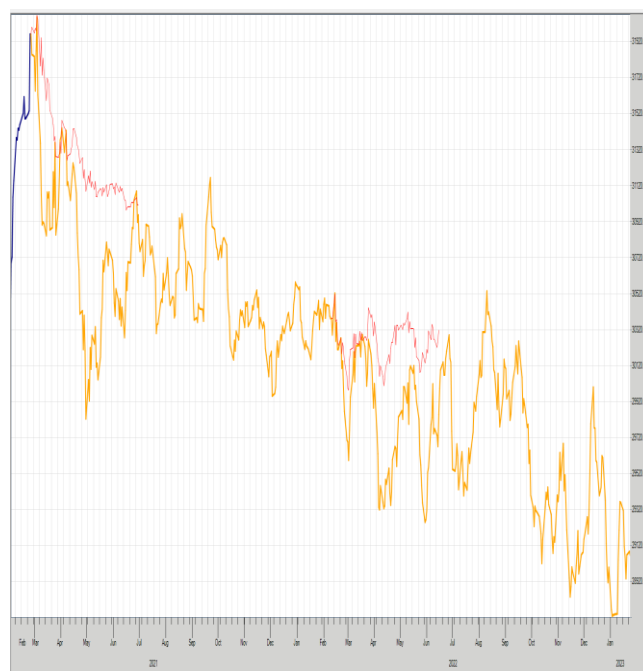
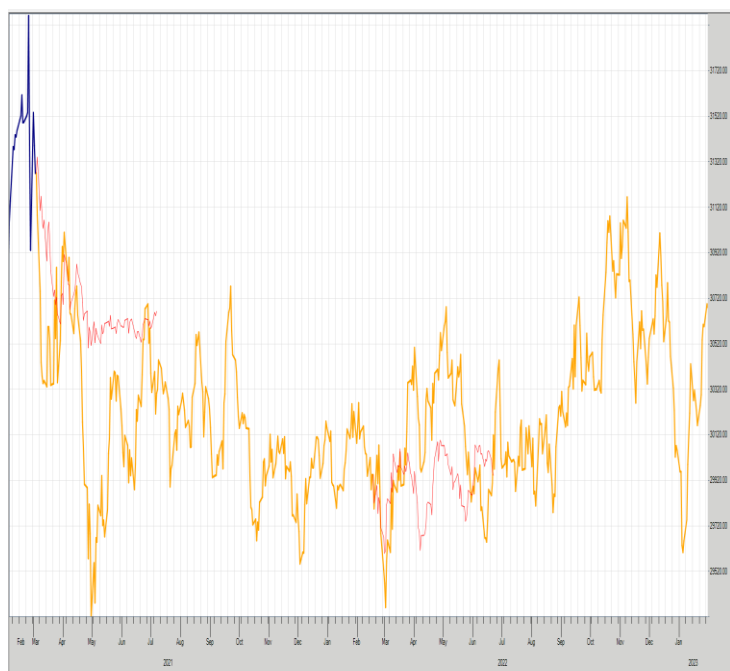
Issue: 9

05 March 2021

**It's a little over 30 years since we first launched a version of the ShareFinder software which employed artificial intelligence to project the likely future direction of securities markets and ever since then I have been closely monitoring the results.**

Over time the system has learned from every mistake it has made in order to improve its accuracy to the extent that I now rely more upon it than I do upon the world's leading economists. But it is not invincible, and its greatest weakness is its inability to calculate with any accuracy the extent of projected market changes.

Thus, for months it has been forecasting the Wall Street's Dow Jones Industrial Index would peak in February, fall back for a few days and then this past week make its last peak before going into something of a death spiral until May. It did exactly that, except that the last peak happened on Tuesday instead of its forecast Thursday and that Tuesday peak was lower than the last one of February 25. And the consequence on future projections of that lower last peak has been quite dramatic:

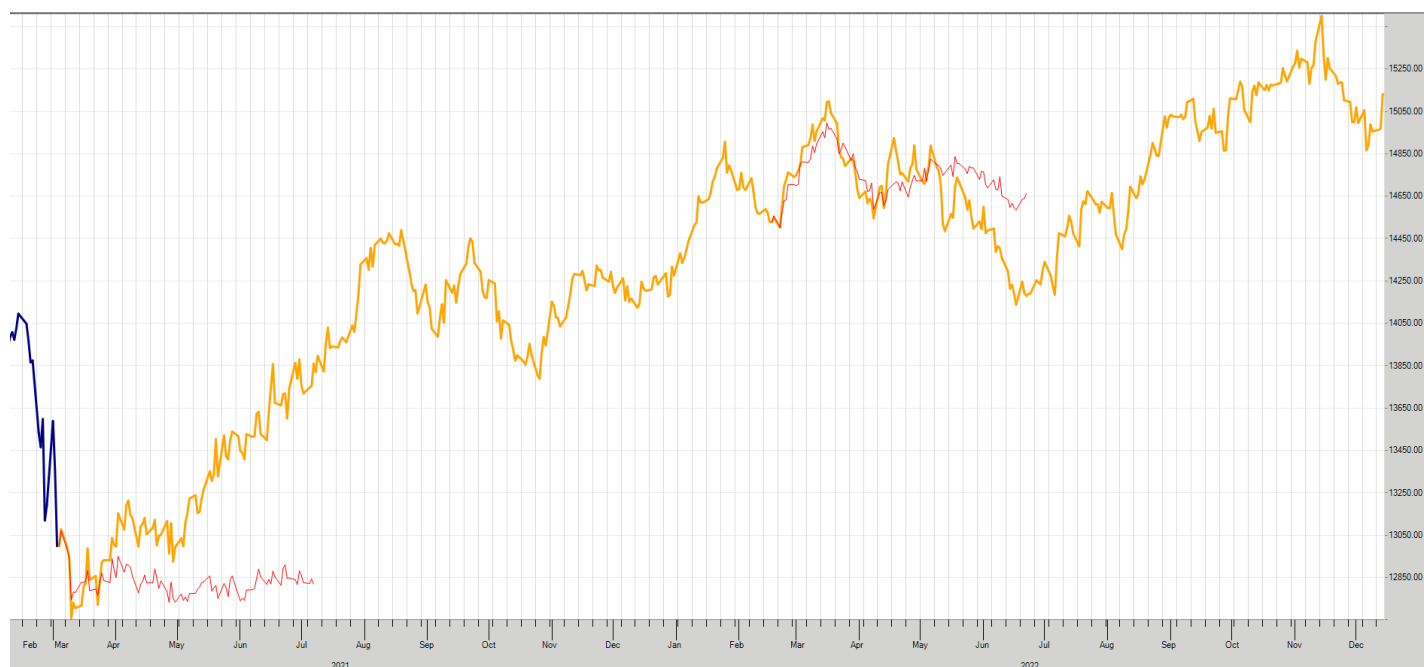


On the left above I have reproduced the latest projection of the Dow and on the right the projection which appeared in this column last Friday. The most obvious consequence is that whereas last Friday ShareFinder was projecting a continued market decline until January 2023, ShareFinder now sees the full decline happening between now and May 3. The same following gains are still being seen from May 3 to September 23 followed by another decline until early March next year and then a second recovery until mid-November only all of the phases will now be a bump along the bottom.

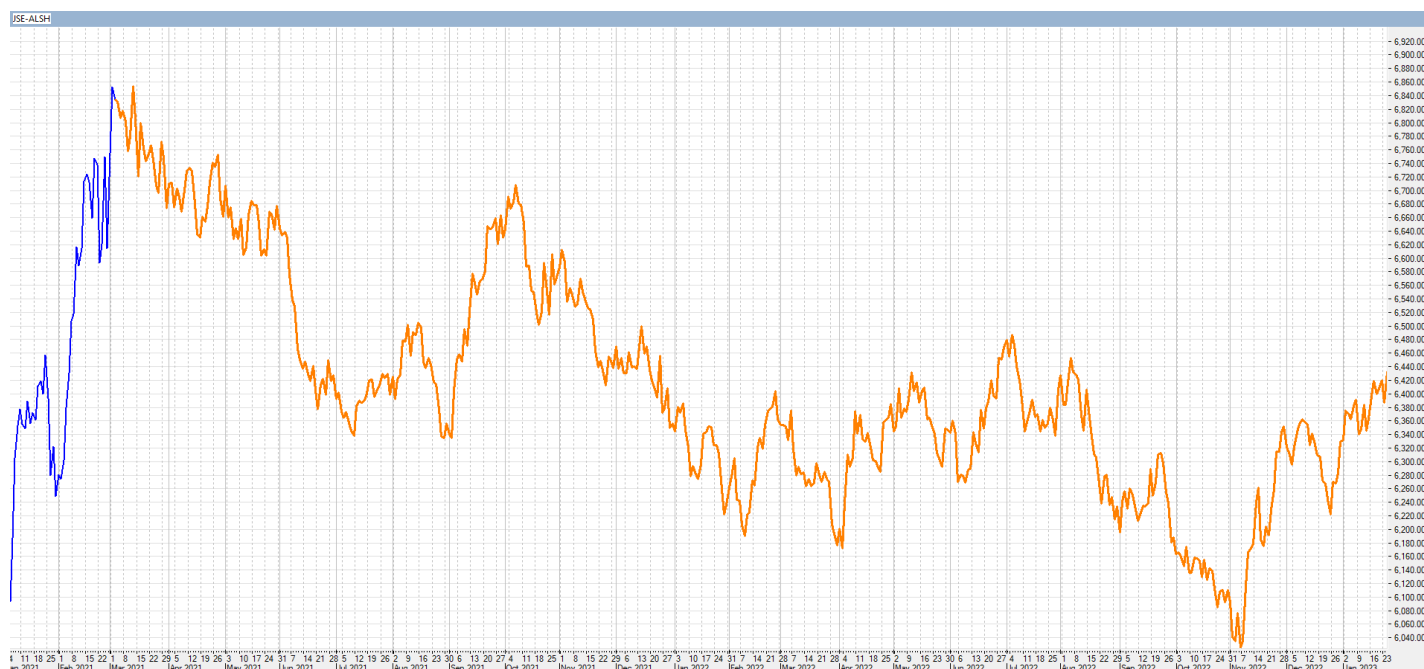
Well, how likely is all of this? Certainly, the talk of a share market bubble is now on everyone's lips and so the inference of what we are seeing now is the cautious money beginning to come off the table. Other investors will need more proof that a bear market has begun. Yet others argue that with Central Banks still printing new money, stimulation is likely to continue.

So, what to do? I am for caution and have been advising readers to take some profit now. In such cases I like to try to liquidate – within the constraints of Capital Gains Taxation – about ten percent of my invested capital so that I have some ammunition available to take advantage of any future weakness. This strategy enabled me early last year to do some really good buying at the bottom and the result since has had a marked impact upon my personal portfolio.

Turning to that alternative US indicator, the tech-rich Nasdaq, ShareFinder argues that it is already half way down its current phase of weakness and should bottom by the end of next week before resuming its upward trend. So if you are playing in that space you might as well hang on for now:



Turning to the JSE, ShareFinder continues to project that this is the end of the recent bull phase and expects a fairly steady decline from here on into a bottom in November 2022 with brief recoveries between late August to early October this year and again from late March next year to early July:



# Do enjoy your weekend!

## The month ahead:

**New York's SP500:** I correctly forecast declines which I still see lasting until mid-March followed by a recovery until mid-April and then a further decline, another recovery until late May and then a long decline until mid-August.

**Nasdaq:** I correctly predicted a brief weakness followed by a brief gain which lasted until the 2<sup>nd</sup>. Now it is likely to be downhill until mid to late March followed by gains until early April and then more weakness until mid-May.

**London's Footsie:** I correctly predicted volatile gains until the end of April and then a steep decline until mid-July.

**Germany's Dax:** I correctly predicted gains which I still see lasting until early April ahead of a big decline until mid-June.

**France's Cac 40:** I correctly predicted the recovery would continue towards a peak in mid-April ahead of a long decline until late December.

**Hong Kong's Hangsen:** I correctly predicted a down-spike that is likely to be over by the end of March when a six-week recovery is likely ahead of a long slide down to mid-July.

**Japan's Nikkei:** I correctly predicted the new up-phase which should last until late-March before turning down until mid-June.

**Australia's All Ordinaries:** I correctly predicted a decline until late March followed by a strong up-tick to mid-May and thereafter a fresh bear phase until mid-September... and my views remain unchanged.

**JSE Top 40 Index:** I correctly predicted the start of a long declining phase until July when I expect the market to bump along the bottom until late-August when quite a sharp recovery is possible.

**ShareFinder JSE Blue Chip Index:** I correctly predicted the beginning of a volatile decline which is likely to last until the end of September.

**Rand/Dollar:** I correctly forecast weakness which I still expect to continue until the end of this month followed by gains until late June.

**Rand/Euro:** I correctly forecast the beginning of a brief recovery until mid-March followed by weakness until the end of the month and then gains until early September.

***The Predicts accuracy rate on a running average basis since January 2001 has been 86.08 percent. For the past 12 months it has been 93.21 percent.***

■ OPINION

**GIULIETTA TALEVI: Big money, cold shivers**

**I have to confess: the bond market gives me cold sweats. Even if my life depended on it, I'm not sure I'd be able to properly explain the relationship between bond prices and yields, never mind the intricacies of the bond market itself — a truly colossal money pit where an almost unbelievable \$128.3-trillion is traded daily.**

The bond market absolutely dwarfs the equity market. It's so big and powerful that James Carville, a former aide to President Bill Clinton, once wished he could be reincarnated as the bond market so he could "intimidate everybody".

Back in 1994, Carville was referring to so-called bond market "vigilantes" — the traders who could bully "spendthrift countries into fiscal rectitude," writes the Financial Times in this week's Big Read. It's well worth a read if you're trying to get your head around the tremendous volatility experienced in the US treasury markets last week.

Now, why do the bond markets matter? Why should we care?

Well, mainly because they determine the cost of borrowing money — which is the lifeblood of every country's financial system, SA included, given the debt that every nation issues.

What's more, there is always a relationship between bond market prices, their yields, and normal equities.

Simplistically: equities (like the shares on the JSE) take their valuation from bond prices; while traders and investors measure a company's earnings or dividend yield against the bond yield. The reason for this is that bonds, on the surface, are theoretically the least-risk investment you can make with an assured payoff — being, their yield.

If you're looking for an explainer of bonds — including their relation to equities, what has been happening of late, and why we should pay attention — economist and investment strategist Mohammed Nalla has written a fantastic post answering all of this.

What the bond market seems to be telling us is that higher inflation is on the way. And higher inflation will, if countries stop all their monetary stimulus and start hiking interest rates, spoil the (spectacular) party in equity markets that we have enjoyed since last year's Covid-inspired sell off, which is on the cusp of its anniversary.

Yet you could also argue that the bond sell-off is a positive indicator.

As the FT writes: “although the economic scars from the Covid-19 pandemic remain significant, the combination of ample financial stimulus and pent-up demand being unleashed by the rollout of vaccines means that analysts are rushing to ratchet up their growth forecasts for 2021. Many now expect the biggest economic boom in generations.”

It all adds up to a tricky time for central banks worldwide as they juggle easing monetary policy, to help fragile economies through the pandemic, and a potential surge in prices.

Lastly, spare a thought for the large corporations in the UK, who will now have to pay a 25% corporate tax rate (from 19% previously) after yesterday’s UK budget, delivered by Chancellor of the Exchequer, Rishi Sunak.

The tax rises have been necessitated by the UK government’s massive Covid-crisis spending plan, which has now hit £344bn, or 16% of GDP.

The Guardian has all the detail [here](#).

In local terms, the UK plan would be equal to R8-trillion. Just imagine that. Consider, too, that notwithstanding a 6 percentage-point hike in taxes, UK firms are still paying *less* in tax than companies in SA, whatever their size.

Still, while we would give our eye teeth for that level of support, or indeed, those sorts of tax levels, the pandemic is going to leave major scars on the UK. For one thing, [writes Martin Wolf in the FT](#) there’s the public sector net borrowing, which will reach 16.9% this year — a level “never before seen in peacetime”

But Wolf raises another question pertinent to SA:

“After the massive response to the pandemic, the needed long-term vision for a country facing an uncertain future is absent. If the one big innovation is an unexpectedly large tax on corporations, what is the plan for economic growth?”

Back in SA, we’d love an answer, too.

*\*Talevi is the FM's [Money & Investing](#) editor.*

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# The money gusher says there’s no stocks bubble yet.

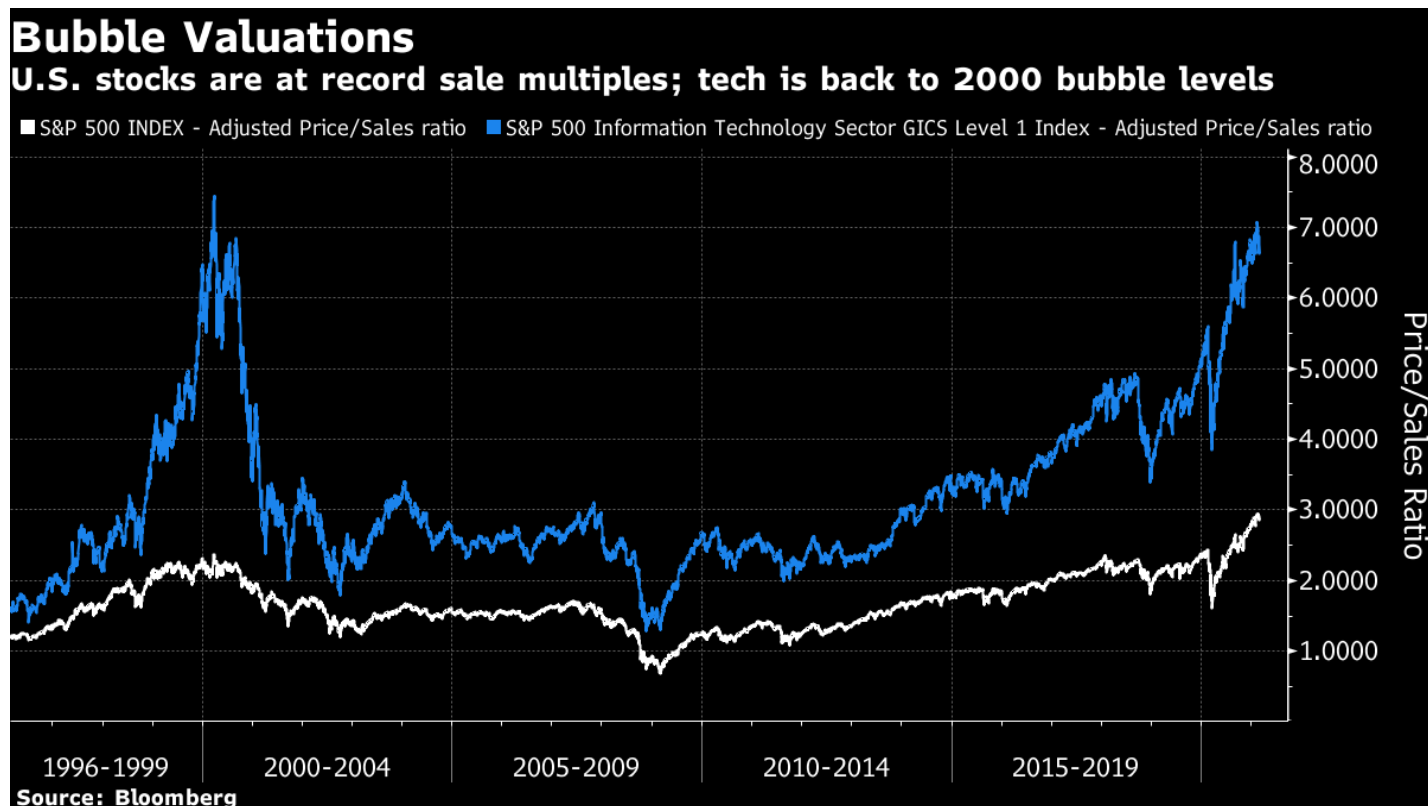
By John Authers of Bloomberg

**A new month, and a new attitude to menacingly rising bond yields. Strong manufacturing data from the US and western Europe, and a rebound for Treasury yields, didn’t stand in the way of a rally in stocks. US equity markets are almost back to all-time highs. GameStop shares rose again, as did the prices of bitcoin (up 14.4% from its Sunday low at the time of writing), and Tesla (up 6.5%).**

This renewed optimism may or may not persist. But it is worth returning to the debate that was consuming commentators until last week's reflation spasm: Is the US stock market in a bubble?

There is a difference between a bubble, which implies overextended and unsustainable valuations that can only be corrected by bursting, and an overvalued market. Stocks don't exist in a vacuum; other asset classes matter. And there is little case that there are true speculative bubbles outside the US.

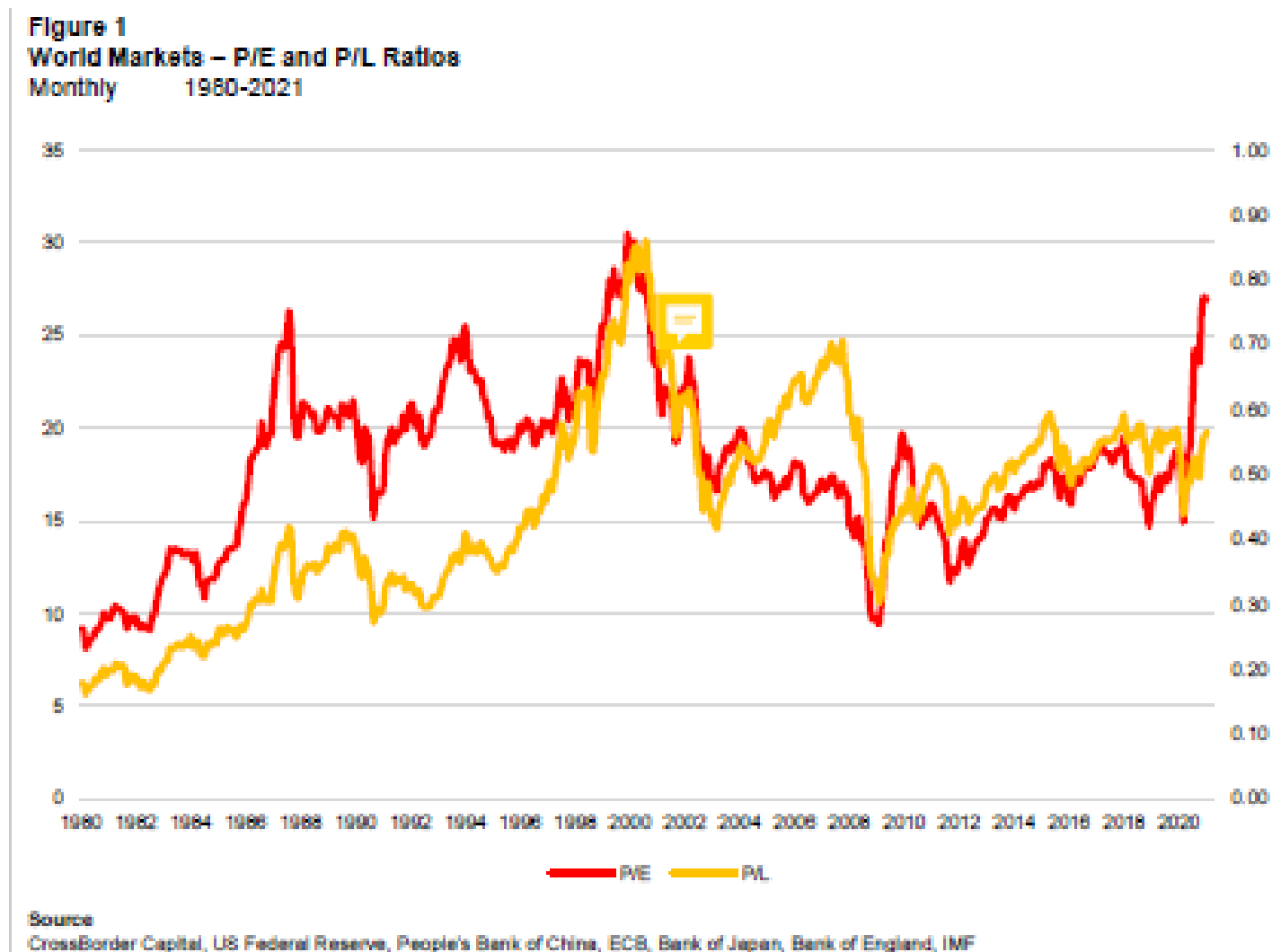
In the US, there is a case to answer. The following chart shows the price-sales multiple for the S&P 500 and for its information technology sector over the last 25 years. On this simple basis, the broad market is at its most expensive ever, and the tech sector is almost as pricey as it was at the peak of the 2000 internet bubble:



US stocks are at record sale multiples; tech is back to 2000 bubble levels

What reputable arguments are there against this? Perhaps the most important one comes from liquidity. There is a lot of it about, with broad measures of money growing as never before after central banks' response to the pandemic last year. Michael Howell of Crossborder Capital in London argues that earnings and sales multiples don't work at a macro market level, even if they do for stockpickers. Howell points out that markets are frequently characterized by a dominant financial cycle, which, in turn, "is driven by shifts in liquidity and in investors' risk appetite." This leads to a search for a broad measure of liquidity; when prices are high compared to liquidity, that is a clue that risk appetite has become excessive.

Here are his estimates for price-earnings (in red) and price-liquidity (in yellow) for world markets over the last four decades:



Source: Bloomberg

On this basis, the market looked as expensive in terms of liquidity in 2000 as it did in terms of earnings, while Howell's measure also produced a good warning that risk appetite was getting out of control before the global financial crisis eight years later. Now it suggests that global risk appetite is roughly back at the top of its range for the post-crisis decade but no more than that, even as earnings multiples suggest that the market is screeching toward a repeat of 2000.

On this view, the danger at this point isn't of risk appetite bubbling over, but of liquidity being allowed to stop too quickly. The analysis confirms that central banks have a very tricky job ahead of them, which is completely in line with intuition after the extreme steps they took last year. But they don't need to worry about deflating a bubble in the equity market, at least at the global level.



As for the concept of “global liquidity,” it was originally developed at Salomon Brothers. Here is Howell’s brief definition:

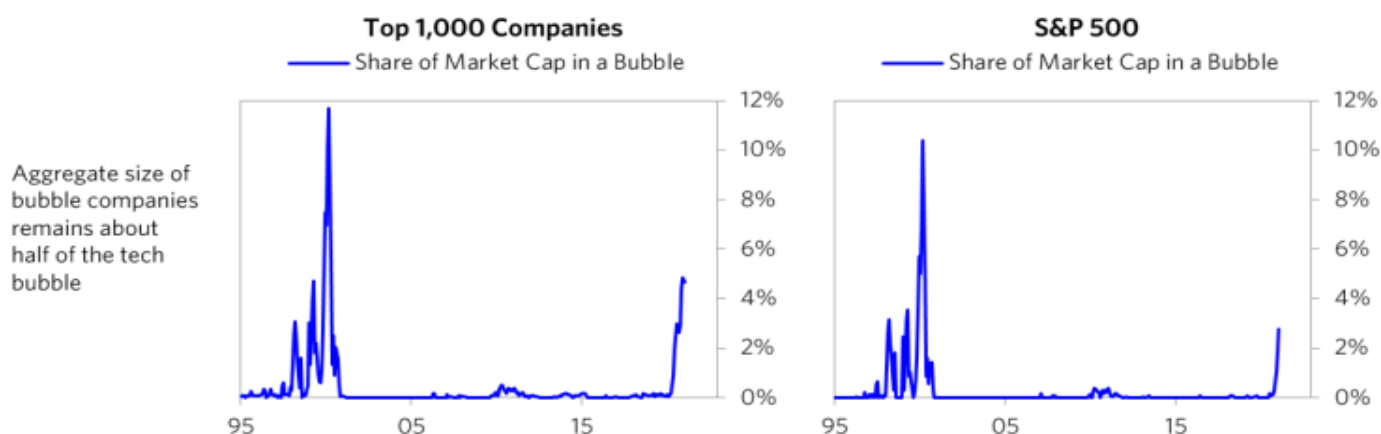
It is ‘global’ because it covers 80 economies and includes cross-border flows, and it is ‘liquidity’, rather than the traditional, narrower measure of ‘money supply’ based on retail banks, because it extends to non-bank credit providers, such as so-called shadow banks. These rely on collateral and operate across the wholesale money markets.

His thesis is fascinating and there is obviously lots of room to argue over definitions, but there is plainly much merit in his basic point that this spike in price-equity ratios is more a response to an unprecedented gush of money than a classic case of animal spirits.

Another convincing push back at the notion of the bubble comes from Ray Dalio, founder of Bridgewater Associates and one of the world’s most powerful investors. Last week he published his own proprietary checklist of whether US stocks were in a bubble. His bottom line:

In brief, the aggregate bubble gauge is around the 77th percentile today for the US stock market overall. In the bubble of 2000 and the bubble of 1929 this aggregate gauge had a 100th percentile read.

So by Dalio’s reckoning, we have a somewhat expensive market, and not a historically great time to buy, but nothing that requires immediate action. That is for the market as a whole. He does look at individual companies and comes up with a measure for how many are in a bubble: roughly half as many as at the top in 2000. There is something to worry about here, but nothing like as terrifying as 21 years ago:



Source: Bloomberg

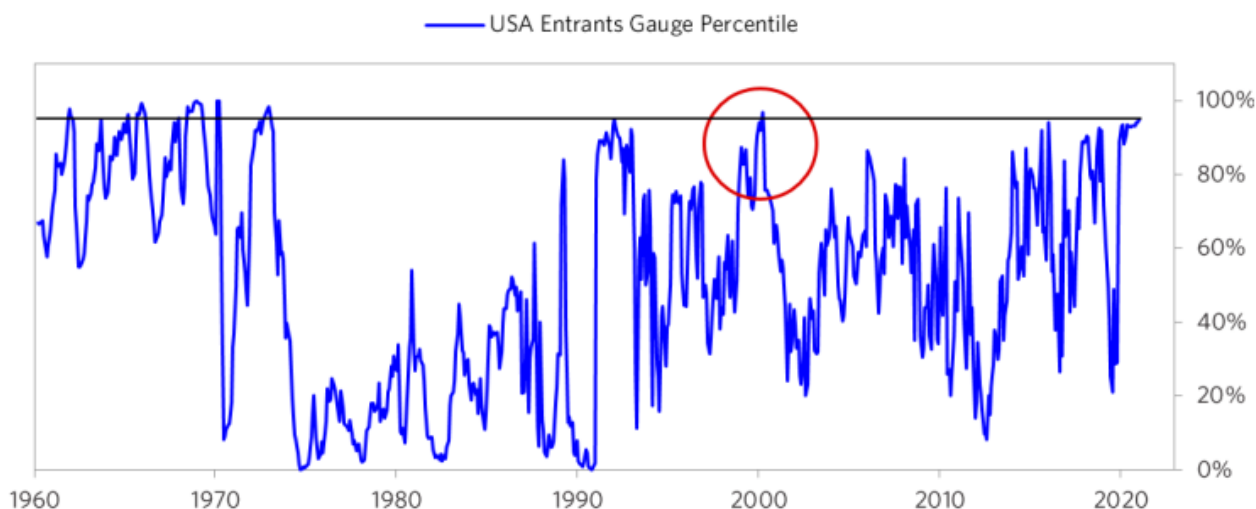
This is how the companies Dalio classifies as bubble-icious have performed compared to the S&P 500 since the beginning of last year. Evidently, the monetary desperation tactics at the outset of the pandemic have much to do with the bubbles in tech:



Source: Bloomberg

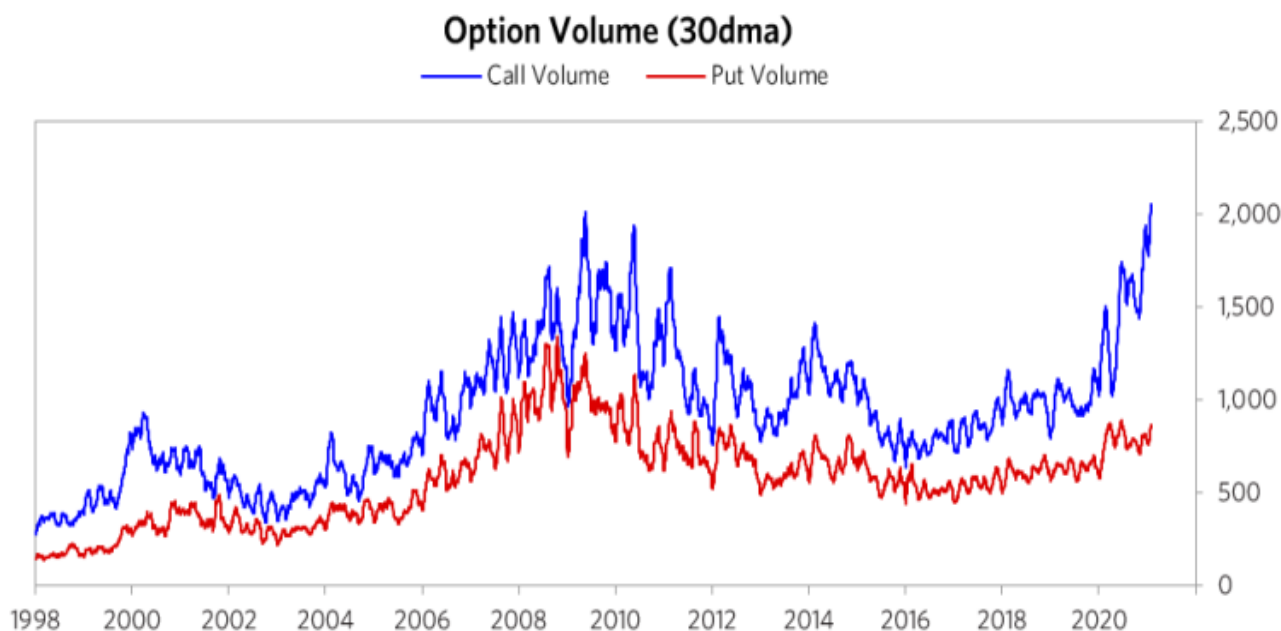


Dalio doesn't go into all the details of how he comes up with his secret sauce, but he does show us what broad criteria look most scary, and which give greatest cause for relief. One measure is the number of new entrants to a market. The more there are, the more dangerously overblown conditions are. On this measure, last year's influx to discount broking has almost led us back to 2000:



Source: Bloomberg

Dalio also agrees with many other observers that the extreme interest in call options in individual stocks (used to bet that their share price will go up) is a danger signal, particularly when compared with interest in put options, which protect against prices falling:

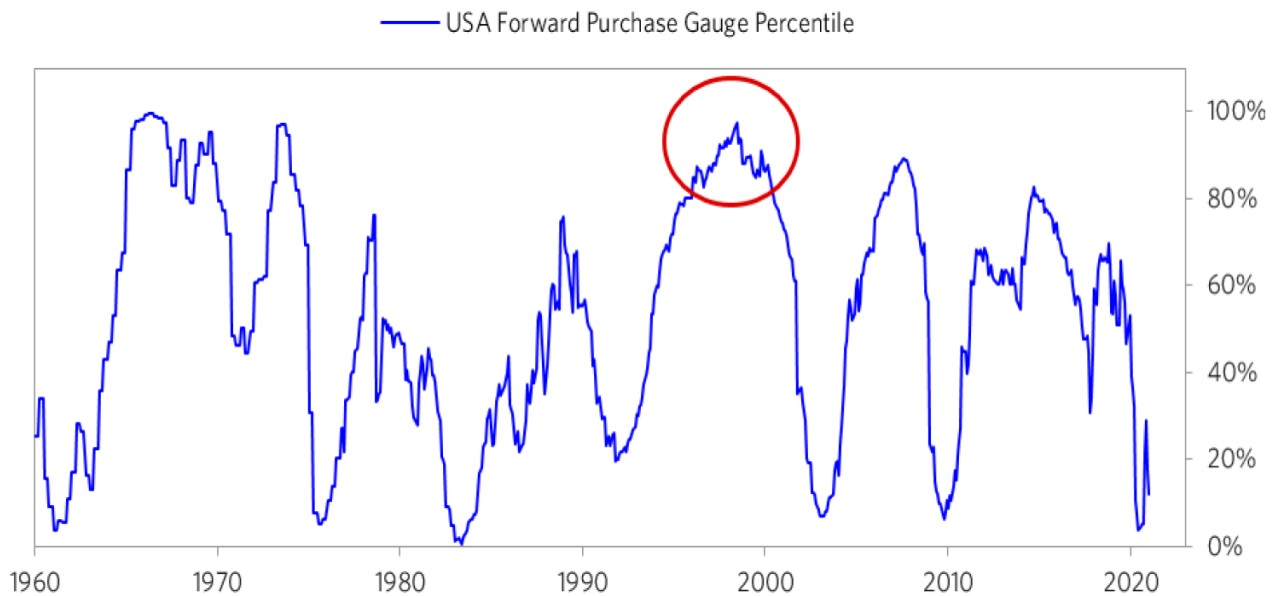


Source: Bloomberg

However, Bridgewater doesn't see excessive leveraged activity outside the retail sector. The key measure that keeps his measure of bubble risk as low as it is, concerns willingness to make forward purchases. Dalio explains this as follows:

We apply this gauge to all markets and find it particularly helpful in commodity and real estate markets where forward purchases are most clear. In the equity markets we look at indicators like capital expenditure—whether businesses (and, to a lesser extent, the government) are investing a lot or a little in infrastructure, factories, etc.

It reflects whether businesses are extrapolating current demand into strong demand growth going forward. At present, relatively subdued levels of mergers and acquisitions, and of capital expenditures, suggest that people aren't relying on such strong demand growth into the future:



Source: Bloomberg

A major resurgence in such activity could easily bring Dalio's measure into bubble territory. As it is, his exhaustive quantitative techniques suggest that we have bubbles forming in the speculative end of technology, but that the reaction of the market as a whole to last year's splurge of liquidity isn't excessive. As with Howell's approach, that still leaves the nagging question of how we deal with an unprecedented gusher of money; but we aren't talking about a direct repeat of 1929 or 2000.

### **"Irrational Exuberance" or "Stupidity"?**

One final measure of bubblieness is behaviour. As Jeremy Grantham of GMO put it when he warned that stock markets were in a new "bona fide" bubble, "crazy" behaviour is the best indicator that a climax is approaching. There is plenty of bonkers behaviour around. Some of it crosses the line from "irrational exuberance" (taking a good idea way too far) into stupidity.

Exhibit a) is Signal Advance, whose shares rocketed in January after Elon Musk tweeted a recommendation to switch to Signal, an unrelated communications app. That case of mistaken identity was cleared up a month ago. But anyone who happened to hold Signal Advance at the beginning of the year, before Musk's tweet, is still sitting on a 300% gain. The stock has quadrupled thanks to a momentary misunderstanding from six weeks ago, which the market hasn't bothered to correct:

# Signal Benefits from the Noise

Signal Advance's share price has still more than quadrupled for the year

Normalized As Of 12/31/2020 ■ Signal Advance Inc - Last Price



Source: Bloomberg

This isn't over-exuberant so much as plain dumb. Meanwhile, on the subject of signals, another indicator that markets are growing distracted is that it is harder to tell the difference between signal and noise. Last week I commented that Cathie Wood, manager of the hugely successful Ark Investment Management, had managed to reverse a dip in Tesla's share price virtually single-handed with the announcement that she was buying shares. Here are two contrasting responses to that comment. One reader wrote:

When someone with deep pockets buys a bunch of stock in a company, that isn't "noise." In fact, it's the very definition of "signal" in the markets. The only way it's noise is if the buyer hasn't done their research and is just investing capriciously, but that's unlikely to happen with a high-value purchase — and certainly isn't the case with Cathy (sic) Woods (sic) and ARK Invest.

I think this is nonsense. The ARK Innovation ETF has been very successful. It's still not that big, and we know that Cathie Wood has been a committed buyer and fan of Tesla for a while. Her actions might count as a "signal" to a small group of devoted fans. It isn't a major market signal. I also received this comment:

Prior to your column, I'd never heard of her. I know a few traders like myself, and most of us, perhaps by being in the much-maligned "Boomer" category, pay very little attention to what goes on in the financial media... We read, perhaps, 1 or 2 commentators, keep abreast of general news developments, and may have one dedicated market news source...

My point being, that far from being deafened by Cathie Wodd's (sic) or anyone else's noise, we actually do much better by not being at all aware of such noise.

My sympathy is more with the "boomer." I also have great sympathy for Wood. My surname is often misspelt, which is irritating, but at least it's an unusual name.

At hectic times like this, virtually everything about a stock like Tesla is "noise" and best tuned out. This is the stock's progress since it topped at close to \$900 per share barely a month ago:

## Come on Feel the Noise

Tesla makes quiet cars but its share price is noisy

■ Tesla Inc - Last Price ■ Close on 01/14 ---- 845.00



Source: Bloomberg

That is as noisy as it gets. And, to be clear, none of this is criticism of Wood herself. Her flagship fund's performance brooks no argument:

## ARK of Redemption

ARK Innovation has outperformed spectacularly in the last 12 months

Normalized As Of 03/01/2016 ■ ARK Innovation ETF / SPDR S&P 500 ETF Trust



Source: Bloomberg

I still wouldn't want to be led by a fund that has recently enjoyed performance like that. Such performance can't be sustained, even if managers continue to make exemplary decisions.

As a cautionary tale, I offer this chart of the rise and decline of the fund known for most of its life as the Legg Mason Value Trust. About 15 years ago, whole conferences would be given over to discussing the remarkable streak of its manager Bill Miller, who used a value style of investing to beat the S&P an incredible 15 years in a row. This makes him the Joe DiMaggio of fund managers; such consistency plainly showed great skill. However, Miller, like Wood now, had a style that worked for the time in which he was operating. When the market turned against value stocks, it did so with a vengeance. Once the streak was broken in 2006, the portfolio suffered a staggering run of underperformance, lagging the S&P by 50%:



None of this meant that Miller wasn't a good manager. But market-beating like that requires a concentrated style. If you wanted to know good value stocks to buy, it was worth following him forever. If you wanted to know whether value would continue to outperform, not so much. Similarly, Cathie Wood is obviously an exceptionally talented tech growth investor. Her decisions don't tell us whether tech growth stocks will continue to outperform. There is something of a personality cult around her at present (which isn't her fault) and that suggests deeply irrational exuberance, if not outright stupidity, in a corner of the market.

### Survival Tips

OK, something to raise the spirits. "The Blues Brothers" is streaming again. I was a bit too young for it when it came out, but what great fun, and what great evidence that Saturday Night Live really was better in the old days. This is Soul Man as performed on SNL, and this is Everybody Needs Someone to Love from the movie.

I'd say it was the funniest rock and roll movie of all time — except of course for "This Is Spinal Tap", which goes to 11. Anyone disagree?

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