Bulls under threat

Feature media interview

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the technical analyst AWARDS 2020 WINNER

T3 Contents

Greed & Fear (p.3)

The "Lollapalooza" Effect (p.4)

FAANG, defang risk? (p.5)

India priced for perfection? (p. 6)

Archive Reports
- Greater Fool Theory
- Taking the Long View
- Fly me to the moon!
- Japan's rising sun

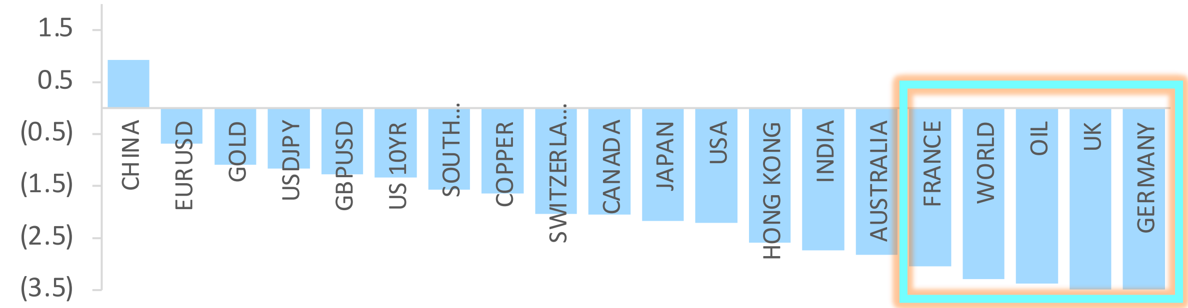
Media Interviews
- Is the Big Cycle About to Turn?
- Is the USD at risk of a collapse?
- Asia's Great Reversal

Educational Material
- Seeking Alpha in a VUCA World
- Value of Technical Analysis
- Trading Psychology
- Behavioral Mistakes

Executive Summary

Global Multi-Asset Ranking Model

		STRATEGIC (LT)	TACTICAL (MT)	ACTIVE (ST)
USA	STRONGEST	USA	USA	CHINA
INDIA		INDIA	SWITZERLAND	USDJPY
CANADA		CANADA	CANADA	EURUSD
SWITZERLAND		SWITZERLAND	USDJPY	GBPUSD
FRANCE	STRONG	FRANCE	GOLD	SOUTH KOREA
USDJPY		USDJPY	CHINA	USA
WORLD		WORLD	WORLD	AUSTRALIA
AUSTRALIA		AUSTRALIA	FRANCE	CANADA
CHINA	NEUTRAL	CHINA	AUSTRALIA	SWITZERLAND
UK		UK	JAPAN	GOLD
GOLD		GOLD	GBPUSD	COPPER
US 10YR		US 10YR	COPPER	JAPAN
JAPAN	WEAK	JAPAN	EURUSD	WORLD
COPPER		COPPER	UK	UK
GERMANY		GERMANY	GERMANY	HONG KONG
OIL		OIL	SOUTH KOREA	FRANCE
GBPUSD	WEAKEST	GBPUSD	HONG KONG	INDIA
EURUSD		EURUSD	US 10YR	GERMANY
SOUTH KOREA		SOUTH KOREA	INDIA	US 10YR
HONG KONG		HONG KONG	OIL	OIL



Market Insights

- **Business cycle sensitive markets, notably Oil** is correcting from price-time inflection point into 200-day average near $72.50. In relative terms, it has now fallen to the bottom of our ranking model. **Copper's** trend is still resilient, after a triple bullish confirmation on the same trend proxy near 430. In terms of LME copper, the red metal is also trading around a make-of-break psych level at $10k.
- **Asia** high-beta, led by **India,** ***"falls from grace"*** on our ranking model, from very overbought conditions, +4 STD from its 20-year mean. Mean-reversion risk is likely into 200-day trend support at 54k. **Japan** is still rangebound YTD, developing bearish distribution top pattern. Key breakdown zone at 27,260-27k.
- **US** & **Europe** unwind from overbought conditions, with the latter triggering elevated volatility. **S&P500** 50-day trend support at 4530 remains key. **DAX** exhibits bearish divergence, after extending a sharp correction under its 200-day trend near 15,400. Next support at 14,800. **FTSE100** capped under summer peak levels, testing psychological level at 7000. Next support at 6800-6820.
- **Gold** remains in a volatile sideways trading range YTD. Key support remains near $1760-20 and $1700, pre-pandemic level. Bulls need to recapture prior highs at $1880, then $1920 to resume long-term uptrend momentum.
- **G3 FX: USD** unwinding from overbought conditions. Near-term support at 95.50 and 94.50. Only below here signals a tactical reversal. **GBPUSD** resuming its YTD downtrend. Below 1.34 unlocks setbacks into psych level at 1.30. **USDJPY** sharp correction back into its Nov low at 112.75. Watch for trend directionality.
- **Digital FX: Bitcoin** correction under peak levels extends under 60k, after triggering a DeMark™ exhaustion signal. **Ethereum** still more resilient, having recently broken to new record levels above 4390. However, a break under 4000 will trigger further losses into 3150.

Greed & Fear

There is **always a time to fear that a strong bull trend will come to an end.** Many investors fear this more often than when the event actually takes place. Worry is a part of life. However, when the bull has already been the longest running in history, such worries are viable. When valuations have been forced well into the highest category for most world markets, there is even more scope to worry. Buffett wisdom teaches us to be *"fearful when others are greedy"*, but **the reality is our biases overwhelm, self-feeding further asymmetric risk** *(Figure 1).*

Initially there is a normal short-term negative seasonal effect. Some of our cycle models signalled elevated volatility into yearend (F*igure 2).* This is based on a quantitative method called *"digital signal processing"* that scans for mathematical cycles. It is developed by the *"Foundation of the Study of Cycles"* and serves as a probabilistic guide, in tandem with robust analytical framework. Traditionally there is high probability of a setback, that can be a crash in the period from late September to late November. However, our timing work **projects further volatility into December.** This may argue against traditional expectations of a "Sant-Claus" rally, driven by buoyant festive sentiment and yearend portfolio rebalancing.

In behavioural terms, **the overriding issue is asset allocation concentration risk,** whereby there seems to be no viable alternative to equities. TINA is the rule. Post black Friday (26th November 2021), many bulls are continuing to proclaim *"buy on the dip!"* Will it be another opportunity, or could this alternate to a dangerous game of *"catching the falling knife".* Alas, the pavlovian conditioning is naturally strong with **previously less than 5% or so drawdown in one year** *(Figure 3 insert)*. This is an unnatural non-volatile world we live in.

Investors should take heed of evolutionary scientist, Charles Darwin on this teaching about surviving change. *"It's not the strongest…nor the most intelligent…it is the one that is most adaptable to change." Figure 3,* headline chart, highlights a potential volatility breakout signal on the VIX, based on a one year compression pattern. **Expect a spike potential into 40%.**

FIG 1. GREED-FEAR CYCLE & ASYMMETRIC RISK

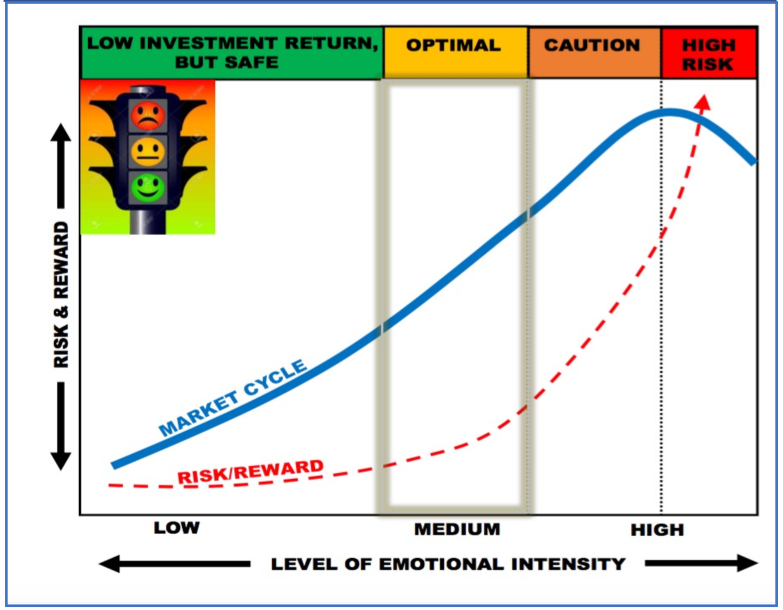


Fig 1. Market cycle schema, with risk-reward profile.

FIG 2. CYCLE MODEL, ELEVATED VOLATILITY YEAREND

Fig 2. Cycle model on VIX. Source. Foundation of the Study of Cycles.

FIG 3. VIX SPIKE RISK, AMPLIFIED BY RECENCY BIAS

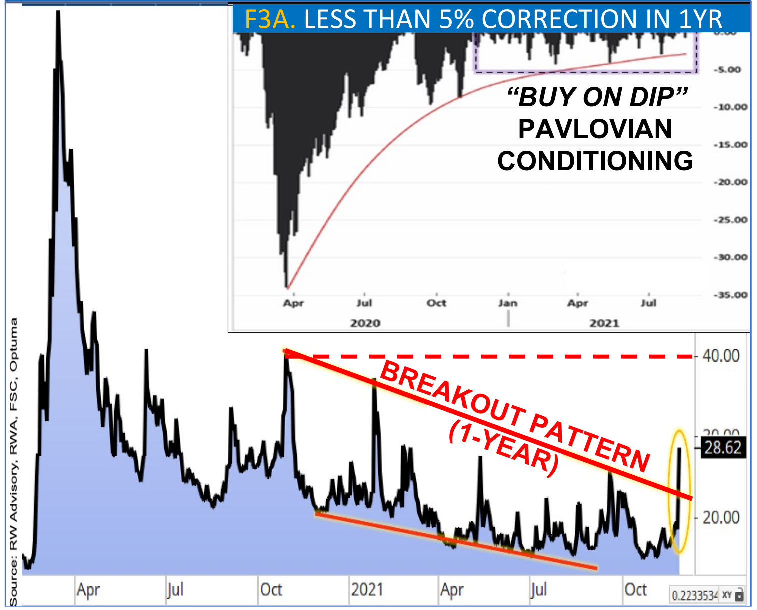


Fig 3. VIX Index & S&P500 drawdown statistics.

The *“Lollapalooza”* Effect

Legendary investor Charlie Munger, vice-chairman of Bershire Hathaway, gave a famous speech in 1995 to Harvard University students about *“The Psychology of Human Misjudgement.”* It featured 25 cognitive (or behavioural) biases that cause misjudgement. A grand-finale bias of this list featured the *“Lollapalooza”* effect; where **psychological biases synergise together, compounding exponentially into asymmetric event risk.** Google analytics warns the strongest current bias is FOMO (fear of missing out), a hybrid of loss aversion and overconfidence.

Both produce the sine-wave extremes of a market’s fear-greed cycle. **FOMO originated from the crisis-opportunity of the 2020 pandemic crash,** which served as the fastest bear market recovery ever! *(Figure 5).* Partly for this reason, many investors faced a rollercoaster panic experience into, then out of, the V-shape bottom. Moreover, behavioural client data from Charles Schwab, highlights that younger and new, first-time traders, experienced variations of the same theme, via herding and recency bias *(Figure 6).* Many enjoyed the best part of a linear bull-trend, marked by *“Rock’n’roll”* investment returns, hitting triple digits across **frothy markets such a Tech, MEME stocks and Crypto.**

Retail traders, akin to the biblical story of **David and Goliath, overpowered at the margin, based on historic liquidity volume** (Figure 7). This was fuelled by mob-like psychology, amassing strength and will in greater numbers. Veteran investors often say the worst trading experience is making money in easy conditions, for the wrong reasons. Why so? A traditional bear market is less forgiving, often punishing with zero-tolerance and a much sharper learning curve. Recall the **average papa bear triggers a quantum drop of 30-50% and most importantly for a time duration of 2-3 years.** In such cycles, a successful market & mind approach is demanded, for relative performance enhancement, risk optimization, grounded by a systematic process. Munger recommends we *“Think slowly. Take a breather…[and avoid] knee-jerk decisions!”*

FIG 4. MILLENIALS POST COVID RECOVERY FOMO

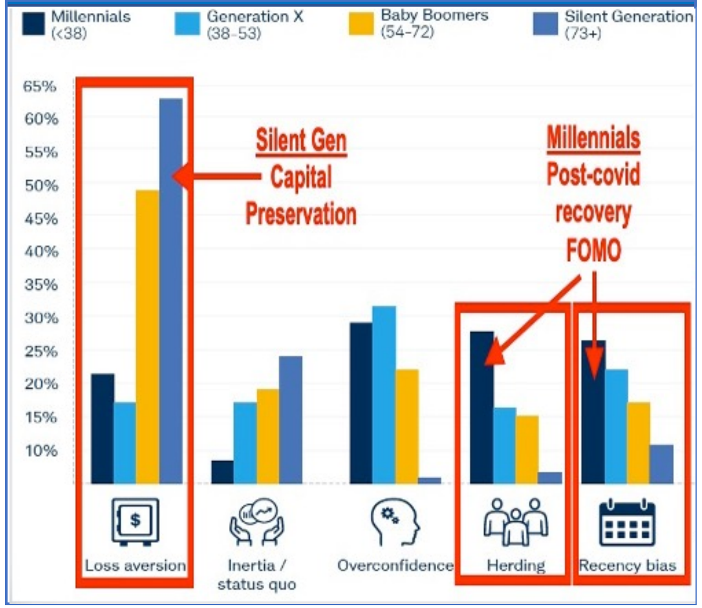


FIG 5. FASTEST BEAR MARKET EVER!

RECESSION	PEAK-BOTTOM	DURATION	RECOVERY
2020 COVID	-34%	0.1 Yrs	
2018 VOL	-20%	0.3 Yrs	0.3 Yrs
2008 GFC	-57%	1.4 Yrs	4.1 Yrs
2000 TECH	-49%	2.5 Yrs	4.6 Yrs
1990	-20%	0.2 Yrs	0.3 Yrs
1987	-34%	0.3 Yrs	1.6 Yrs
1981-82	-20%	1.0 Yrs	0.2 Yrs
1973 OIL CRISIS	-48%	1.7 Yrs	5.8 Yrs
1962 JFK	-20%	0.5 Yrs	1.2 Yrs
1929 CRASH	-86%	2.7 Yrs	22.3 Yrs

FIG 6. 2020 CRASH & THE V-SHAPE RECOVERY EFFECT

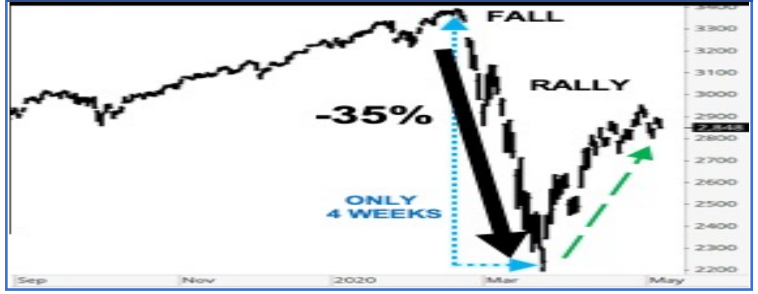


Fig 5 & 6. China oversold momentum and sentiment.

FIG 7. DAVID BEATS GOLIATH, BUT AT WHAT PRICE?

Fig 4. China MSCI investable growth index. Source: BCA.

Fig 7. Shenzen & Shanghai composite. Source: EWI.

FAANG de-fang risk?

Figure 8 warns the turmoil might just be getting started, with the NYSE FAANG+ Index, which is comprised of mega cap names like Facebook Inc and Amazon --- **could risk another dip below its strategic 200-day trend average,** akin to the past October. The prior test was the first time in 18 months, following a worst quarter since the pandemic rocked markets in 2020. The last time a similar breach occurred for the tech gauge was in October 2020, with the broader S&P500 Index proceeding to tumble more than 18% before bottoming by Christmas Eve.

A sustained break will confirm a top reversal signal, where FAANG stocks will run the risk of being de-fanged. While their obituaries have been retracted before, intermarket correlations also signal that US technology megacaps have the most to lose should the Federal Reserve make good on its pledge to remove stimulus. *Figure 9* highlights the prior spike in Treasury yields pressured the richly valued FAANG group. It also recalls a déjà vu analog earlier in the year when a surge in 10-year yield rattled the tech cohort. Though rising yields and peaking earnings post a threat, **elevated valuations still offer contrarians a paradox.** NYSE FAANG+ Index trading at about 28 times estimated earnings for the coming year, versus about 20 times for the S&P500 *(Figure 10).* That's the narrowest premium since December 2018, when tech giants bottomed out and recovered to new record highs. Could this happen again?

Our Roadmap model continues to warn of late-cycle asymmetric risk, marked by **underperformance of overvalued growth stocks and potential new opportunities in value names.** Currently, S&P500 energy and financials offer strong breadth scores, while defensive lag. Meantime, closer examination of the individual FAANG stocks exhibit important top reversal and breakdown patterns. Both **Facebook and Amazon are previous high mean reversion risks** *(Figure 11a & c).* Watch the remaining stocks, with Apple, Netflix, Google and Microsoft likely to mean-revert into their 200-day averages, near 138, 556, 2513 and 273 respectively *(Figure 11b, d, e & f).* **Beware of the grand domino effect!**

FIG 8. FAANG TECHNICAL CLIFF NEAR 7000

Fig 8. FAANG Index

FIG 9. DÉJÀ VU?

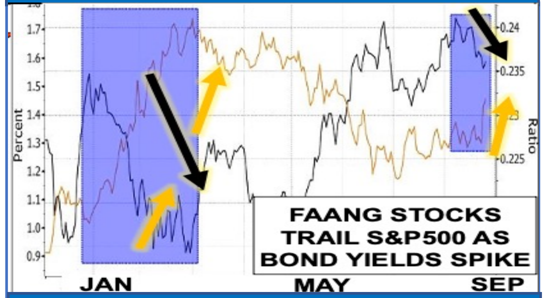


FIG 10. BACK TO EARTH

Fig 9 & 10. FAANG, Yields & Dividend ratio.

FIG 11. FAANG STOCKS MEAN-REVERSION RISK INTO 200-DAY & BEYOND

Fig 11. FAANG stocks, Facebook, Amazon, Apple, Netflix & Google.

India equities prices for perfection?

India's equity market is unwinding, as we predicted, after going vertical in both absolute and relative terms. Moreover, trend regression analysis warns the market is likely *"priced for perfection",* having already **overstretched by +4 standard deviations from its 20-year mean** *(Figure 12).* Our Roadmap cycle *(Figure 12b)* suggests this derivative of the secular bull-run is complete and due a tactical mean-reversion towards the strategic 200-day average, currently at 54k, with a **risk of a deeper drop to 47k, which equates to 20% below peak levels.**

This is an optimal time to take profit and look to buy at more attractive levels in future. In relative terms, Indian equities are outperforming EM by a near-record 94% *(Figure 13).* Incidentally, this is not related to the China-TMT meltdown, as performance remains unchanged ex-EM TMT. High frequency data for net foreign equity inflows, which were extremely hot earlier this year, have cooled down *(Figure 14)*. **Retail speculation is rife, suggesting that the *"Greater fool theory"* is in operation:** investors are leveraging momentum extremes, and will sell quickly if the market corrects. Cross-market divergence is found in the Nifty 50 Index, continuing to rise beneath its old trend-channel, which is often a sign of slowing momentum ahead of a top *(Figure 15).* An ideal target remains at 18,632, wave equality.

Another warning signal would be if the Nifty small-cap 100 Index falls out of its channel to below 10k. IPO froth is also a concern, after already rising to an all-time high this year and now reversing. The S&P BSE IPO Index, an index of stocks that have gone public within the past two years, is lower now than it was in mid-July, possibly indicating a slowing of demand for high growth, new economy companies, ahead of a top. **Internal breadth measures further amplify vulnerability,** marked by a falling percentage of stocks holding above their 50-day average, which remains below its June 2021 peak *(Figure 16).* All this implies a healthy technical unwind and perhaps some invisible concerns on the horizon. Local experts cite macro headwinds and geopolitical risk. Notable candidates include steep oil prices, the **US withdrawal from Afghanistan, latent terrorist forces and India's socially charged 2022 state elections.** Astute investing is often built on scenario-planning. He who fights and runs away, lives to fight again on another day. We are not looking for a bear, but a setback, but cash for now looks good.

FIG 12. +4 STD FROM 20-YR TREND AVERAGE

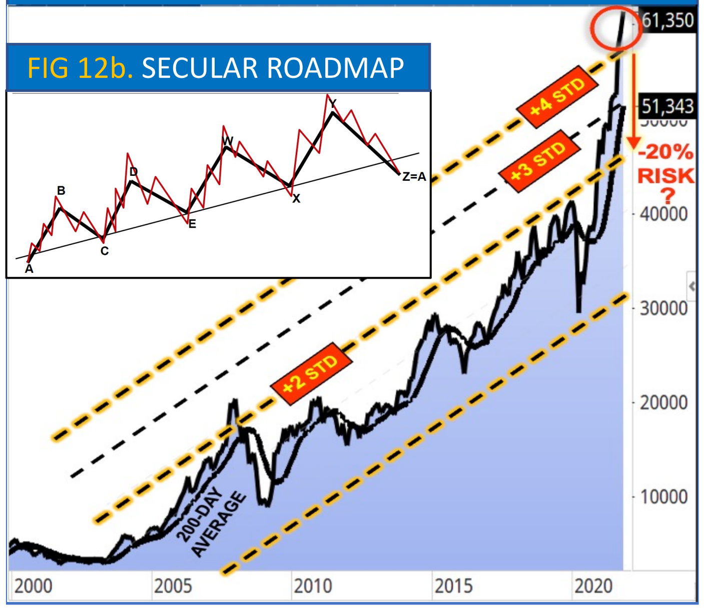


Fig 12. SENSEX Index & long-term regression analysis.

FIG 13. INDIA/EM PREMIUM +2STD

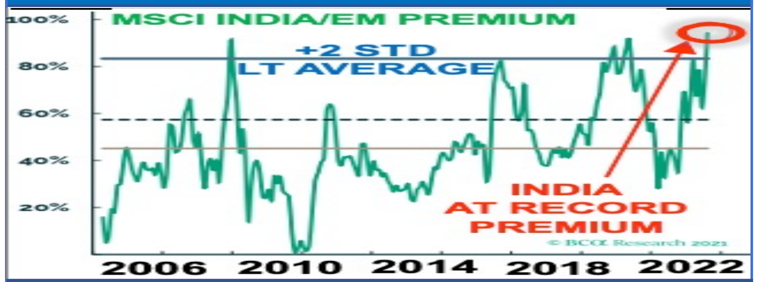


FIG 14. INVESTMENT SLOWDOWN

Fig 13 & 14. India/EM & Investment flows.

FIG 15. NIFTY50 TREND WEAKNESS

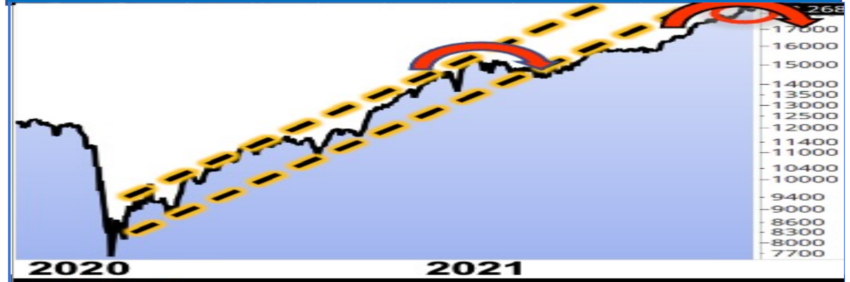


FIG 16. BREADTH DIVERGENCES

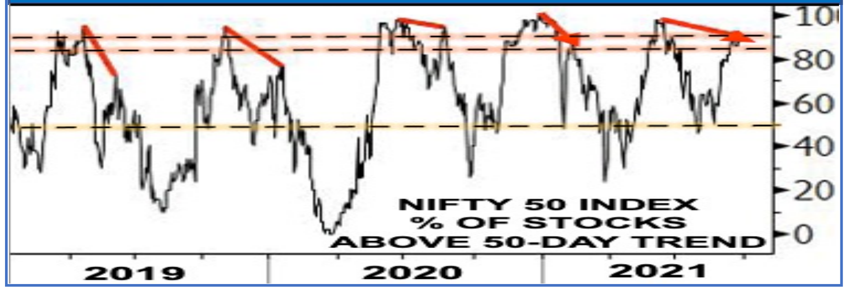


Fig 15 & 16. Nifty50 & Breadth measures.

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