Macro Thoughts & Outlook

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First of all, sorry for the brief hiatus in recent weeks. I took an unusual vacation and found myself without internet for much of the trip. Also, the research database is finally built and the old research files are all uploaded. If you haven't received a log-in from me by the end of next week then call me and fire me. Or kindly email and ask for the username and password. I prefer the email. I'll reach out to everyone personally by the middle of next week when usernames and passwords are established. That said, a lot has happened in the last few weeks so let's get to work.

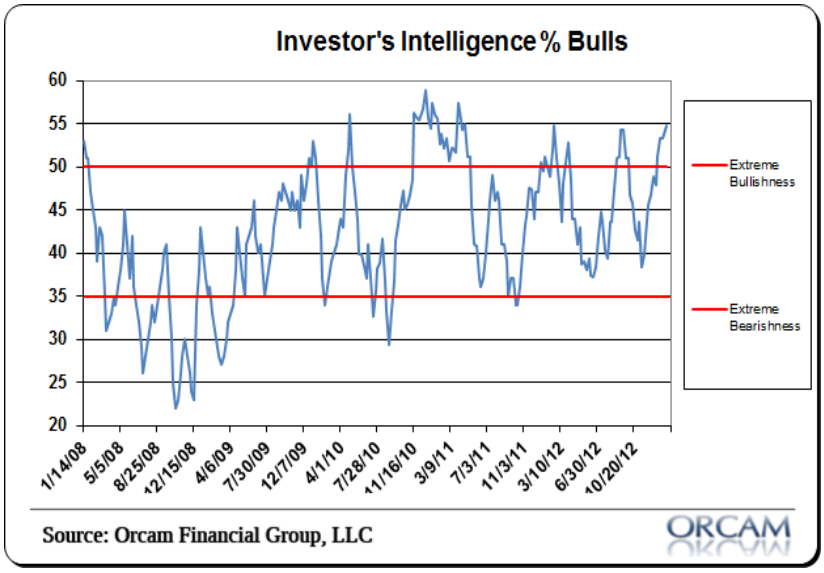
"Strong Like Bull"

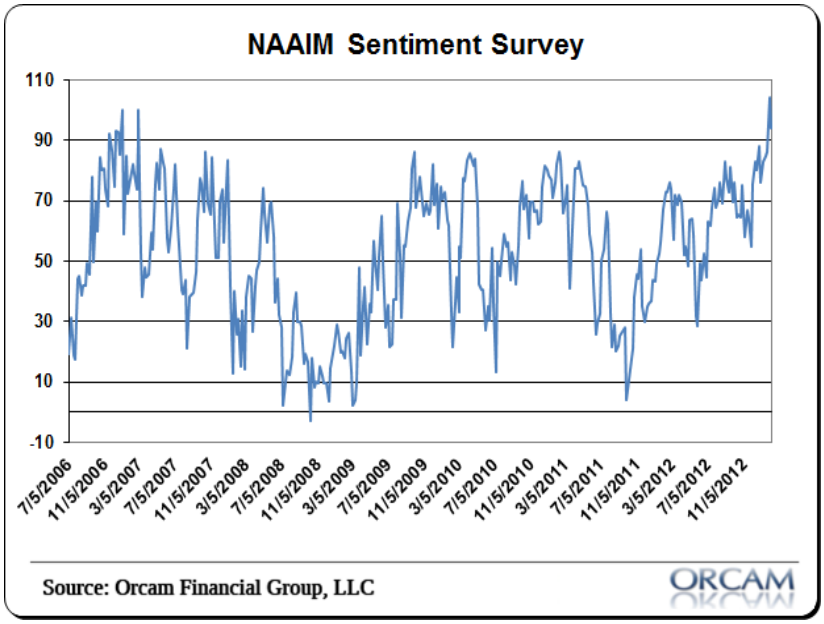
Let's cut to the chase. This market feels like there's nothing that can bring it down. From our strategic positioning (longer-term), I've remained bullish, but from the tactical view (short-term) I've been wrong recently. Investors are clearly coming around to the view that the economy is better off than most presume. But that doesn't mean the market is without risk in the *near-term*. In the Intelligent Investor Ben Graham wrote:

> "The intelligent investor realizes that stocks become more risky, not less, as their prices rise—and less risky, not more, as their prices fall. The intelligent investor dreads a bull market, since it makes stocks more costly to buy. And conversely (so long as you keep enough cash on hand to meet your spending needs), you should welcome a bear market, since it puts stocks back on sale."

"Risk comes from not knowing what you're doing. "
-Warren Buffett

There are few things more difficult in the investment world than controlling one's emotions. When the market is rising we feel a sense of comfort and safety and when it is declining we feel a sense of angst and worry. It is precisely the wrong way to attack the market. Yet Ben Graham's simple message is forever forgotten by market participants.



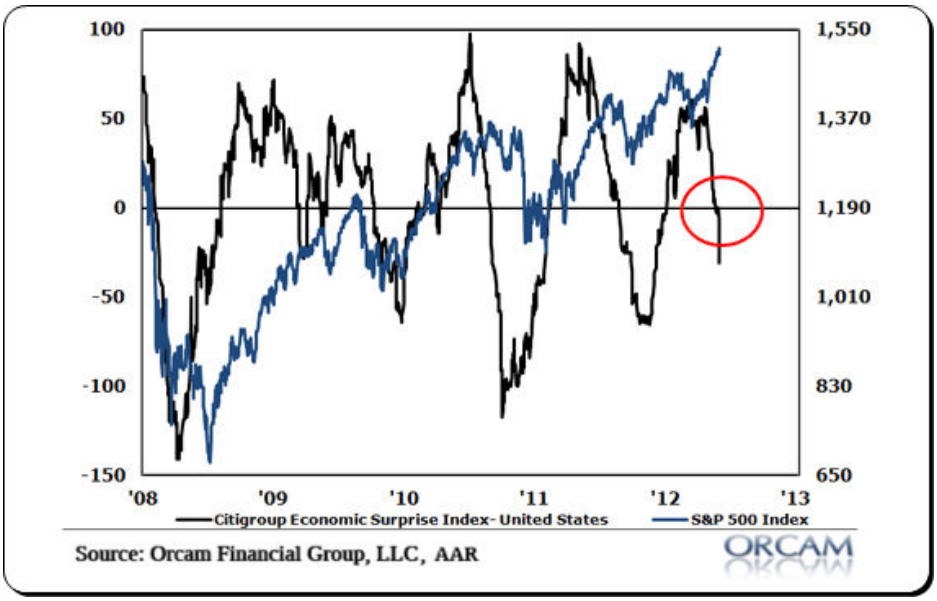


This can be seen clearly in recent sentiment surveys which have literally gone through the roof. The NAAIM Sentiment Survey of money managers is so high I had to alter the axis to make the record high readings fit. The Investor's Intelligence Survey is telling us a similar story. These are highly unusual sentiment readings that should make us all sit back and take pause.

With the market at new highs and sentiment going through the roof you have to begin to question whether the market isn't inherently more risky now than it was just a few months ago when I was decidedly more bullish. To me, Ben Graham's message screams loudly at us that risk management is the prudent approach to this market and the risks remain elevated at current levels.

The Stock Market is not the Economy

Similarly risky developments are occurring in the broader economic data. Although the consensus has now come around our view that the economy is better than most presume, the data has actually weakened compared to expectations. This can best be seen in the Citigroup Economic Surprise Index below. Despite this weakness in the data, the S&P has continued to move higher. This wouldn't be alarming if the CESI hadn't had such a longstanding high correlation with the S&P 500 over the years.

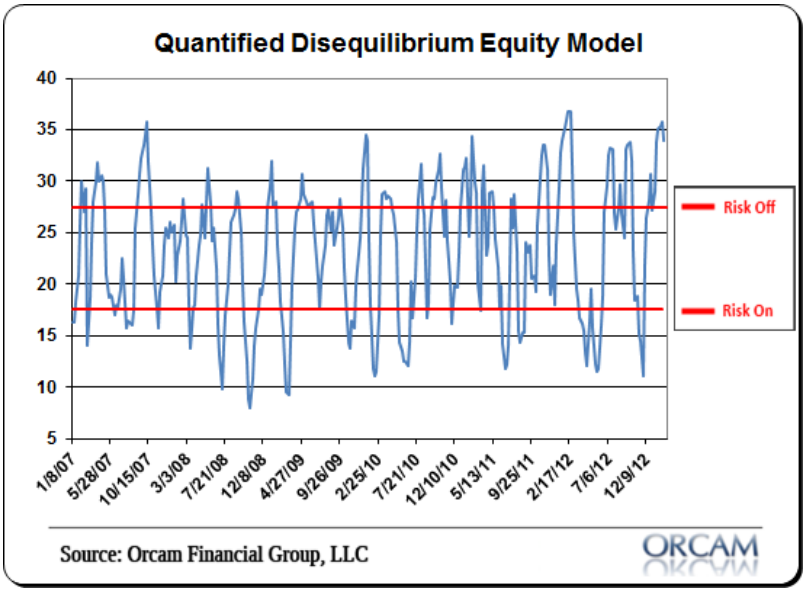


Don't get me wrong, I am still modestly bullish on the global economy for reasons I've detailed in the past and that leads me to remain constructive from a strategic positioning, but we mustn't confuse this with the tactical view of the market. The stock market can and will deviate wildly from the economy at times and while I expect the cyclical forces to dominate the long-term trends, we have to remain wary of these sorts of divergences in the near-term.

Caution Remains the Name of the Game

This all adds up to one neat conclusion: risk remains elevated at present. This is all confirmed by my primary tactical model which points to an unusually elevated level of disequilibrium in the market at present. Please see the chart on page 4 for details. Of course, this doesn't mean the market can't continue to move higher, but we're not in the business of being involved in every single little move the markets make. It would be great if I had a crystal ball that told you every single move the market makes, but we're not in the business of counting cards or reading crystal balls. We're in the business of calculating risks and quantifying when the market is attractive and unattractive. We can make this

complex and we can make it simple. But Ben Graham's simple message rings true at present. Stocks become increasingly more risky as they rise. And rise they have. The S&P is up 13% in 2.5 months. The Shanghai Composite is up 25%. And the Nikkei is up 28%. Buy low and sell high is not nearly as complex as most will have you believe. It's just that most of us don't have the mental fortitude to adhere to a strict plan. And if we're to think of our tactical cash allocations as an option with no expiration date then we should be willing to allocate that cash when the market appears to be making extremes. At present, I remain more inclined to sell than to buy.



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