On My Radar: Investors Behaving Badly
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“The secret to my success is that I buy when everyone else is selling and I sell when everyone else is
buying.”

- Sir John Templeton

There were several charts that caught my eye this week. The first is a chart that tells us the likely
annual return for the S&P 500 Index will average just 2.25% over the next ten years. Many valuation
measurements support a period of probable low future returns, but this particular data is different – it
looks at the percentage of household equity ownership.

Think of it this way: It looks at how much potential buying demand there is for stocks from households.
When fully invested in stocks there is less available demand to drive prices higher. When under
invested the opposite is true. You’ll see that the data shows that returns are higher after periods of low
ownership and lower after periods of high ownership.

There were just two prior periods of higher equity ownership than where we sit currently. One was the
market peak in March 2000 and the other in October 2007. Unfortunately today, the percentage of
household equity ownership is approaching the level reached at the market peak in 2007.

The second chart I share looks at non-equity liquid assets. The idea here is to see how much free
liquidity is available to buy stocks. If you ever have wondered if investors buy and sell at the wrong time
this shows that data in real time. Let’s call it “investors behaving badly”. Show the chart (below) to your
client the next time his emotions look to overtake logical reasoning. The great Sir John Templeton’s
wisdom rings in my head.

Finally, I asked Ned Davis Research if I could share with you a recent research piece that Ned shared
with his institutional clients like CMG. In it Ned takes the research on their popular “Big Mo”
(Momentum) indicator back to 1929. As you’ll see, it remains modestly bullish at present.

Given the high level of household ownership and high current market valuations, risk is elevated. I
believe that now is the time to be focused on risk management and become more tactical in approach.
I share some ideas today.
This week’s post is short. I hope you find it helpful.

Included in this week’s On My Radar:

- What the Percentage of Household Equity Ownership Tells Us About Probable Future Returns
- Investors Behaving Badly

**What the Percentage of Household Equity Ownership Tells Us About Probable Future Returns**

Here is how you read this chart. First, the blue line shows the percentage of household financial assets invested in equities. The dotted black line plots the actual rolling 10-year returns of the S&P 500 Total Return Index.

Correlation measures how closely the market’s rolling 10-year returns follow the Household Equity Percentage. A correlation of 1 is a perfect match. A reading between 0.80 and 1.0 reflects a very high correlation. You can see it visually in how closely the dotted black line follows the blue line.

The red arrow at the top of the charts shows the ownership at the market peak in 2000. The left vertical scale shows that households had 65% of their money invested in equities at the market peak in 2000. It accurately identified the 10-year period of negative returns that followed.

The smaller red arrow marks the percentage of equity ownership at the market peak in 2007. Same story.

Take a look at the green arrow at the market bottom in 2009. Great annual returns followed but were individual investors prepared to seize that opportunity? Then, fear in the air was palpable.

The orange circle shows where we are today. Expect low forward returns, be risk focused, stay tactical and patient – a better buying opportunity remains ahead.
Investors Behaving Badly

Warren Buffett says to be fearful when others are optimistic and optimistic when others are fearful. Household equity is one measure of over and under ownership. The next chart takes a look at “Household Fee Liquidity”. Think of it as available money that can be used to buy equities.

The red arrow points to the gain per annum when household liquidity is low. Not surprising – returns are low (and in this case negative). The bottom section of the chart shows where we are “today”.

There is little available liquidity today. It is lower than it was in 2007 and lower than it was in every other period except 2000. Personally, I think 2000 to be an outlier.

In regards to “investors behaving badly”, take a look at the amount of available liquidity at the market low in 2009 (“Panic selling 2009”). The sad truth, perhaps, is that the behavior of the many creates the opportunity for the few.
In the “what you can do” category, here are a few ideas as it relates to portfolio equity exposure (the point is to have a plan in place that protects you from the really big declines):

- Set a plan in place. Markets can certainly go higher.
- While the various “valuation”, “household equity ownership” and/or “free liquidity” data are helpful at identifying probable forward returns, they are less valuable risk timing tools.
- The great Paul Tudor Jones suggests a trailing 10% stop loss from the market’s high water point is prudent. Not a bad idea but needed too is a rule to get back in or remove set hedges.
- Some like a simple 200-day moving average to identify trend, some a 1% move below that MA line. Hedge or sell on negative cross. Remove hedges or rebuy back in on positive cross.
- I like a 13/34-Week Exponential Moving Average cross (see Trade Signals below for detail)
- My favorite is NDR’s “Big Mo”

I’m excited to share, with permission from NDR, Ned’s recent research piece on Big Mo.

**Ned Davis on Big Mo (Momentum)**
Ned has a very humble and balanced way. This past Monday, Ned took his research back to 1929 (with the help of market data from Kenneth French). I found the deeper data set encouraging. While the process has run live for many years, prior data went back to just 1980.

Here is the link to the full piece (a quick read). Click here for NDR disclosures. NDR’s is an independent research firm. If you are a professional advisor or institutional investor, you can reach out to Dan Dortona, in their Boston office, at 617-279-4860 to learn more about NDR. (Please note: I am simply an NDR client and do not get compensated in any way. Just a fan.)

Personal note

Spring here in the northeast is being ushered with another snow storm. It is peaceful watching the snow fall outside but it is getting way too old. Warmer weather can’t come soon enough. Looks more like global cooling than it does global warming.

As a crazed soccer family, the eight of us are bundling up and heading to tonight’s Philadelphia Union vs. Dallas game. The forecast is for temperatures in the high 20s. The upside is that the ice cold beer should stay ice cold. Seems a family room with a warm fire going is the better move but what the heck – we are going for it.

Here is to hoping that this is the last snow storm. I’m ready to see some flowers. Come on spring!

I hope you find this week’s post both interesting and useful.

Have a great weekend!

With kind regards,

Steve

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