



Peter Schenk - 778-400-2813: [peter.schenk@wprivate.ca](mailto:peter.schenk@wprivate.ca)  
Matthias Raps - 778-400-2812: [matthias.raps@wprivate.ca](mailto:matthias.raps@wprivate.ca)  
Marc Vella - 778-400-2815: [marc.vella@wprivate.ca](mailto:marc.vella@wprivate.ca)

**"Be sure the patient remains completely fixated on politics."**

- C. S. Lewis (*The Screwtape Letters*)

## Bottom Line:

There is plenty going on, as always, but I think that the current "Trump story" is less relevant than the United States Federal Reserve jamming trillions of dollars into the economy. The correction in stocks could continue, or maybe get worse, but this remains a bull market.

## Big Picture. How I view the coming months/years

Tom Dorsey of Dorsey Wright and Associates is a pioneer in the type of analysis that we use in our portfolio management process. In a nutshell, that analysis boils down to systematically buying strength and selling weakness. Done correctly, this process can give you a small edge over time, and a small edge is all it takes to succeed.

The process and the edge are another story. The point I want to make today is that Dorsey wrote a great piece in 2010 that discusses the idea that when markets got more volatile it was wise to step back and take a bigger picture view, not get closer to the "action", as that would only serve to confuse. On one hand, the long term is made up of a bunch of short terms and I believe there are times when tightening up your stop losses is appropriate. However, in the big picture Dorsey was correct.

In what is becoming an increasingly murky world, especially after President Trump's COVID-19 diagnosis and the ensuing developments, one thing is clear: the market is going from one worry to the next. Of course, the concerns about Trump's health and its potential repercussions are valid. Yet it is also valid, and I believe it is the bigger picture, to monitor the status of the political process regarding the combination of aggressive fiscal and monetary stimulus that has boosted asset prices since the spring.

The continual pounding of the psyche that comes with a society increasingly wound up in media, both social and otherwise, enhances the short termism in society. That has impacted short term market reactions at the same time that the markets are increasingly impacted by computer programs, buying and selling aggressively on the news of the day is.

Increasingly, daily market action is becoming meaningless and the focus, both fundamental and technical, needs to be widened. So, instead of handwringing and trying to guess what the next headline or its effect on prices might be, it's imperative to cut through the clutter and the intraday noise and pay attention to our longer term systematic principles and rules.

In the book **The Price of Tomorrow: Why Deflation is the Key to an Abundant Future** (2020) by Jeff Booth he discusses the forces of deflation. Technological advances that create such efficiencies that one of the

consequences, not the least of them, is pressure on employment and wages. Wage growth of course is a major input into inflation calculations but when competition is high you can't keep asking for more money as a fast food worker or Walmart employee. All the bodies have to work somewhere. If you do keep asking for a raise, you'll find out just how fast a robot can do your job instead of you. And robots don't ask management for anything. They can be employed nonstop (between lube jobs) and management doesn't have to feel bad. They can spend their weekends fishing or playing with the kids while their nameless robots toil away 24/7. No problems, no guilt, no protests, less inflation pressure.

The other side of course is the inflationary angle that is the central bank, or banks. The closest thing we have to a guarantee is that politicians will always focus on the short term and do the expedient thing in the interest of getting re-elected. In today's world where we are unable to find significant economic growth due to the heavy yolk of massive mountains of debt, this politicism clogs the economic engine leaving us fighting the same battle with the same tools as they dug up in 2008.

We can rest, virtually assured, that they will never stop. To keep this story short, it results in inflation and I think we are seeing it now, and maybe we have for some years. They will continue to report low inflation of course. It wouldn't do to actually tell people their cost of living is rising, as if we can't see it ourselves in real estate, food, tuition and most other things, outside of television sets, for the last ten years. All the money has to go somewhere.

In my career I've seen three asset bubbles:

Internet stocks – 1999

Mortgages – 2007

Short volatility - 2017

(A short side trip: The latter may need some explanation for the non-finance nerd type. The US Federal Reserve's actions have an effect on asset prices, including equities. The story there is the same as it's ever been. The "market" gets to have a say in the evolution of policy. The effective communication loop between policymakers and markets clearly dampens volatility in general across the board, at least until it doesn't.

Up to the end of 2017, exchange-trade products betting that volatility will sink lower had never been more popular. Even as the [Volatility Index](#) plunged to its lowest on record and U.S. stocks march to fresh highs, these short volatility exchange-traded funds were backed by the most cash on record as investors were lulled to sleep, only to be awakened in early 2018.

The chart below shows this. In the top pane you see the equally weighted S&P500 and its advance into the end of 2017, ending the year with no corrections much larger than three percent. A record setting year for calm in equities.

Like all bubbles, this one ended too leaving the stock index with no gains since then but setting new highs and lows in bigger swings than ever as the index which measures volatility has risen (bottom pane).



All these asset bubbles were created by the fed. But then these same bubbles were burst by the fed tightening and followed by bubbles in cash (or fear).

- Summer 2002
- March 2009
- March 2020



Effectively these cash bubbles were burst by Fed easing. Given what we know about the proclivities of politicians and central bankers, and taking the big picture view we discussed earlier, it seems rather simple that we are going to get more money printing which will likely lead to the next asset/stock bubble.

## Aren't we in a bubble now?

On any given day you can find "investment people" with complete opposite opinions on anything. Some today are screaming there is a bubble in stocks. But then many of them have been screaming the same thing every quarter for about ten years.

The S&P500 is up about 6%/yr since Jan '18

The average stock in the S&P500 (equal weight S&P500) is up about 0% over that time.

The Value Line Geometric Index (measures 1700 North American Stocks) has grown about 0% for 23 years and down about -23% since Jan 2018

Small cap stocks (Russell 2000) is down about -10% since Mid-2018.

Call it what you want but while there are some areas that are certainly bubble-ish many sectors are on the cheap side and have been ignored for years. Ask oil & gas or bank stock-holders if they are in a bubble.

If you look you can find many things for investors to fret about. The U.S. election is on everyone's mind and is getting closer. Now investors are growing increasingly doubtful that the election will produce a clear result for president.

Around the world, news stories have been filling up with talk about potential voter fraud. Will the Supreme Court have to get involved? Will the Ruth Bader Ginsberg replacement even get installed to the Supreme

Court? Frankly, will either side accept a loss if the results appear dubious. And like the many possible outcomes, the market response to them is impossible to predict.

What seems easier to predict is that we can expect more volatility. Yet whatever course the markets take over the rest of 2020, the more important question is whether the volatility is taking place during the onset of a secular bear market.

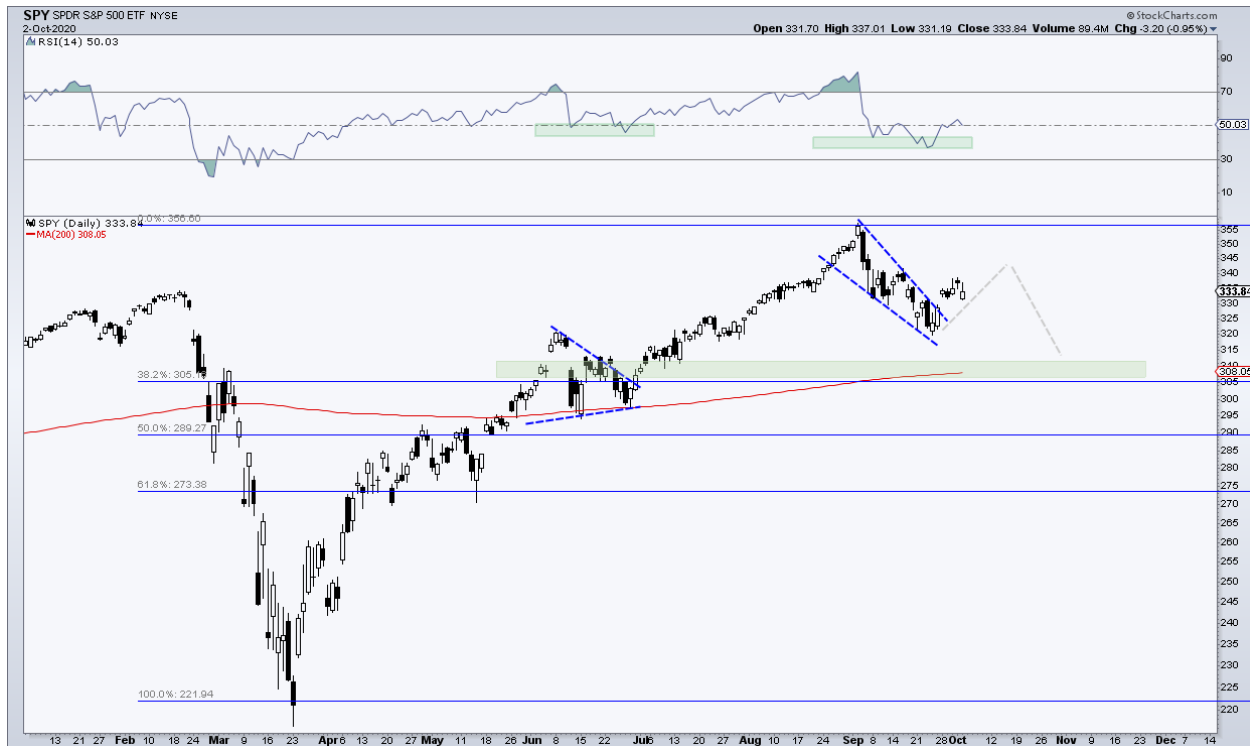
The election worries have elicited comparisons to the disputed U.S. election of 2000, also a year of elevated volatility. The “hanging chad”/recount debacle and debate was eventually ended by the Supreme Court in favour of George W. Bush. It took until December 12 that year, and the start of the 50% decline in most stock indexes was already in.

My view is that we are not in an equity bubble like 2000 yet. For one thing, the P/E on the S&P500 was 44X earnings. It is now about 23X earnings. More importantly, interest rates are low, central banks will print money until they can't, and fiscal policy of massive government spending on infrastructure projects seems likely to become comparably massive as monetary policy in the next couple of years, likely putting more wind at the back of equities in coming months or years.

## In the Markets

Last week, the short-term downtrend reversed with a breakout higher on Monday and this breakout is holding. We are also in the turn of the month period and this eight-day window shows a bullish bias over the years. This window covers the last four days of September and first four days of October, and ends on Tuesday.

On the daily chart we [posted last weekend, here](#), we drew a grey dotted line which was basically our base case (best guess). The breakout from Monday Sept 28th is holding. For now, the breakout is bullish until proven otherwise and I am watching Monday's gap. A close below 328 would fill the gap and negate the breakout. This would then argue for a return to correction mode and we could then see a decline back to the 310 area on the S&P500 ETF, SPY.



## Conclusion

Last week we concluded with “These are amazing times, and I’m confident we will have another up leg this year where our portfolios see meaningful growth.” I still think that.

We will stay patient and monitor individual positions until such time as our Primary Trend Indicator and Buying Power Model turn negative, at which time we would reduce exposure to equities as a rule.

The stock market is clearly trying to recover from the September correction, but uncertainty is rising. While our PTI remains positive, the major market indexes remain undecided, much like our SPY chart above. Given the theatre that is US politics, there is likely to be more uncertainty and price volatility.

While we, as investors, should be ready for more market volatility as the election nears, we should also not underestimate the upside potential driven by central bank money pumping and government fiscal policy beyond the current noise.

We remain completely open to any eventuality that the markets bring. Our strategies, tactics and tools will help us to successfully navigate whatever happens as we focus on monitoring supply and demand signals that the market provides us.

Have a very good weekend and we’ll be in touch with you soon.

Peter Schenk, CMT, CIM | Portfolio Manager

P: (778) 400-2810 E: peter.schenk@wprivate.ca

Words we operate by:

“Deliver to the world what you would buy if you were on the other end. There is huge pleasure in life to be obtained from getting deserved trust. The way to get it is to deliver what you would want to see if you were on the other end.”

-Charlie Munger

“Strive not to be a success, but rather to be of value.”

– Albert Einstein