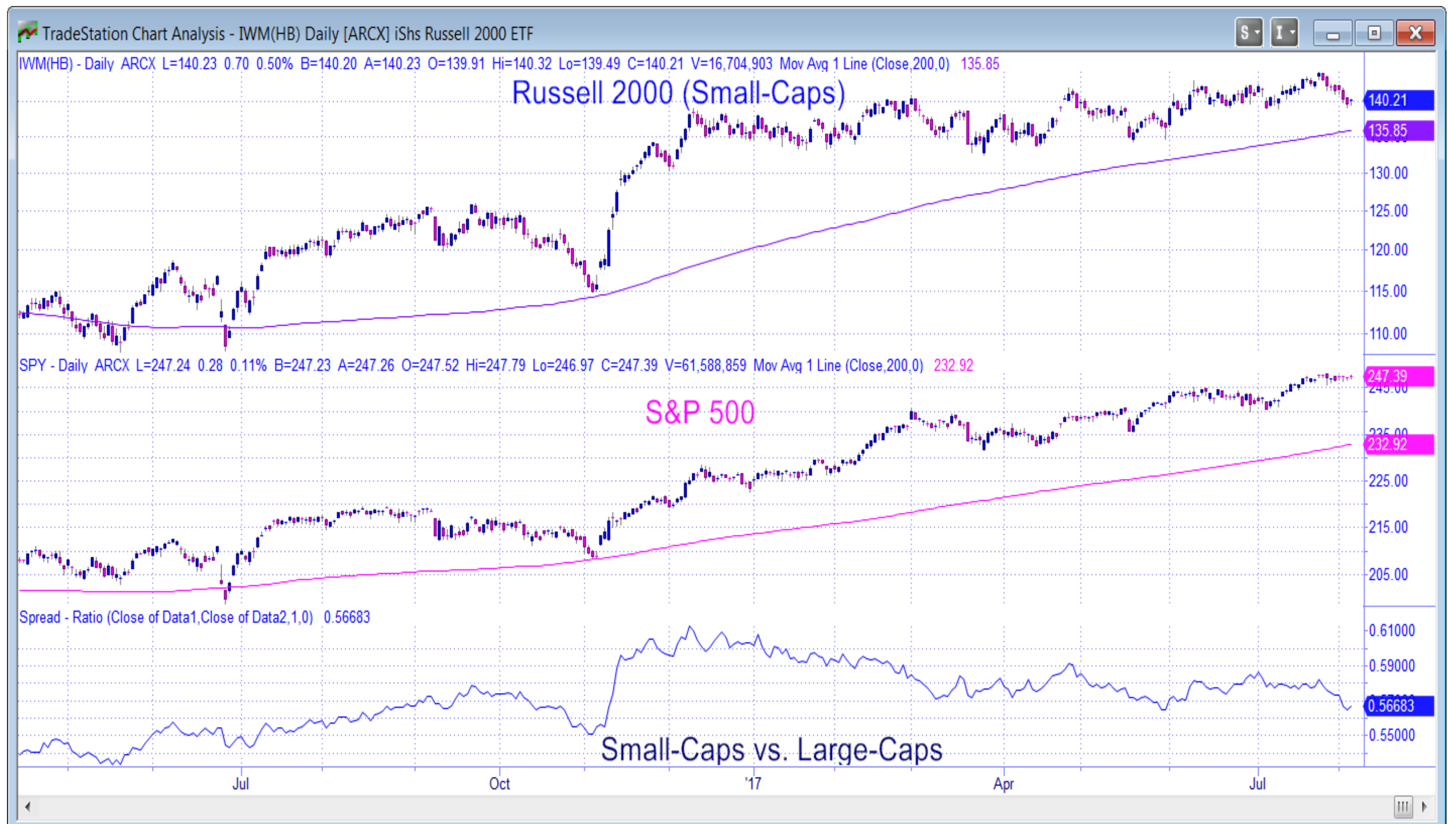
Titan Capital Management, LLC
Global Market Letter

August 4, 2017 **Abe Askil, CFP®**

DOW 22,000

This past Wednesday the Dow Jones Industrial Average rose to 22,000 for the first time ever. There is some good news and bad news regarding this. The good news is that the rally which began last November is still intact as the major U.S. indices are either making new all-time highs or close to their all-time highs. The bad news is that 10% of the Dow stocks have provided 50% of the gains this year. Basically, half of the Dow's gains this year are attributable to Boeing, Apple and McDonald's. When the market is led higher by fewer and fewer stocks, it is more vulnerable than when it is led higher by a broad range of stocks. This type of narrow leadership has historically preceded market tops. It is important to have broad participation during healthy market rallies, so more stocks should participate in the future if the current rally is going to continue. In the months ahead the markets will be primarily focused on whether or not the incompetent bureaucrats in Washington D.C. will be able to pass tax reform in order to provide fiscal stimulus and when the Federal Reserve will start unwinding of its balance sheet. Investors are taking monetary policy tightening in stride for now, but that could change very quickly. Especially, if the long awaited fiscal stimulus in the form of tax cuts does not materialize.

Another sign of narrow leadership is coming in the form of small-cap stocks underperforming large-cap stocks. You can see in the chart below (fist pane) that small-caps have mostly been range bound this year and not joining in on the new all-time highs party. They are up about 4% year-to-date which is less than half of the gains of large-caps as represented by the S&P 500. While the S&P 500 is close to its all-time highs, the Russell 2000 Small-Cap Index is approximately 3% below its highs. The third pane of the chart below shows the performance of small-caps vs. large caps. The declining blue line means that small-caps are underperforming large-caps. This may be a temporary phase and we could see small-caps join the large-cap party. However, if small-cap weakness continues we could see large-caps joining the small-cap weakness party which would be negative for the general market.



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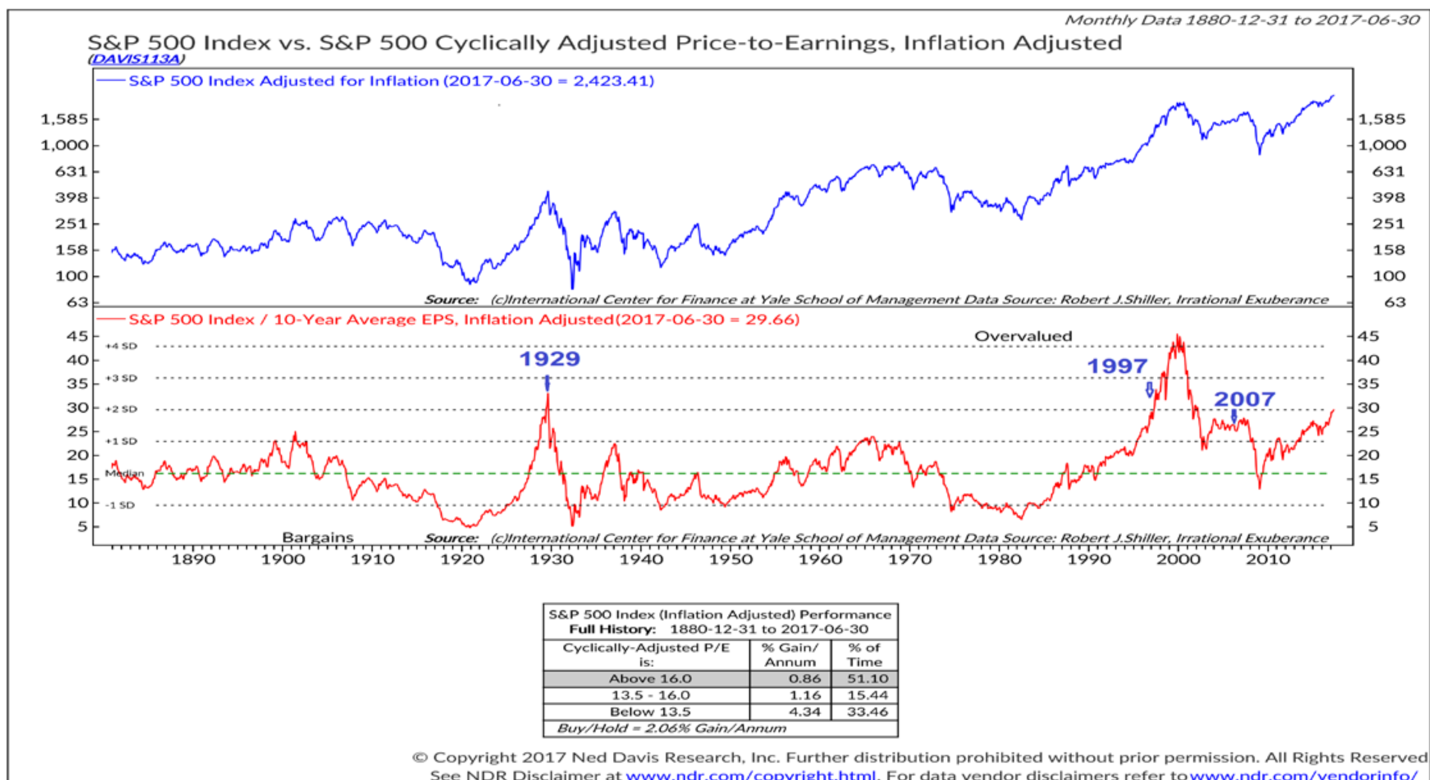
CAPE HITS 30

It has been a while since I have talked about market valuations. Since the CAPE (Cyclically Adjusted Price Earnings) Ratio recently rose above 30, I thought it would be a good time to revisit the current market valuation. A price-to-earnings ratio of 30 means that investors are willing to pay 30 times $1 earnings. The CAPE goes back to 1871 and since then has only been above 30 a few times. The chart below shows that it was at 31.48 and 32.56 in August and September 1929 just before the market crashed. The next time the CAPE would rise above 30 would be about 70 years later in June 1997. Unlike in 1929 when it only stayed above 30 for two months, the CAPE rose for two and a half years rising to 44 in December of 1999. Just like in 1929 it peaked just months before the market topped. To compare current valuations to those of the 1990's is simply absurd because in the 90's we had real innovation, real economic growth and real earnings growth. Since 2009 we have had nothing but artificial propping up of asset prices while economic and earnings data have been abysmal. The reason valuations are so high is because prices have far outpaced the fundamentals. This can certainly continue longer and maybe the CAPE will rise to 40 over the next few years. Remember, the market can stay irrational longer than one can stay solvent. Whether the CAPE stays above 30 for several years and the market continues to rise as it did in the late 1990's or peaks in a few months as it did in 1929, our models will get us on the right side of the major trends. We are prepared and equipped to deal with either scenario.



Cyclically-Adjusted P/E is:	% Gain/ Annum	% of Time
Above 16.0	0.86	51.10
13.5 - 16.0	1.16	15.44
Below 13.5	4.34	33.46

Buy/Hold = 2.06% Gain/Annum

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THE BOTTOM LINE

Our trend models Alpha and Omega are both positive. Investor sentiment is at extremely optimistic levels, which is generally negative for the market. However, investor sentiment indicators can be early and can stay elevated for some time before the market peaks. There is also very little fear amongst investors with the VIX at 10. August and September have historically been the worst two months for the market, I suspect that fear may rise over the next few months.

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