Market Signs

Buy low and sell high.

Buy panic and sell euphoria.

Buy when there is "blood in the streets".

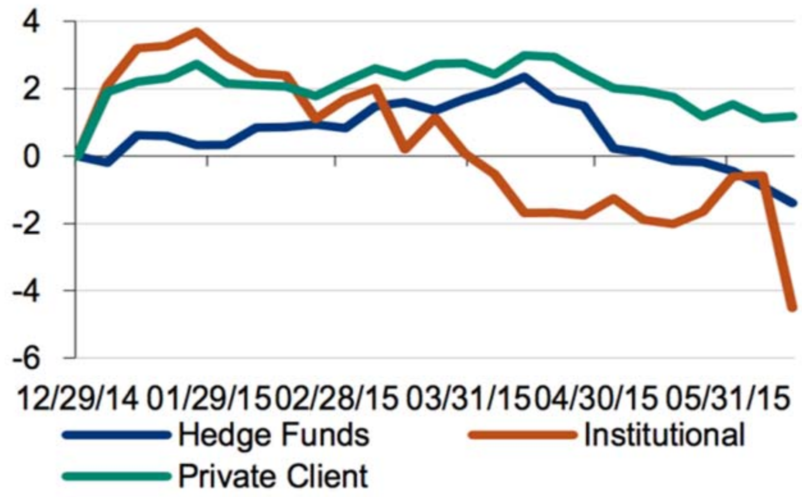
Buy on the cannons and sell on the trumpets.

There is no doubt you've heard at least one or all these sayings. To sum each one up, the best time to buy is when you least want to because of the fear of all the bad things that may lie ahead. And, the best time to sell is when you least want to because of the fear of missing out on potential future gains (see last month's column on *FOMO*). If the best time to buy and sell end up being when you least want to, the end result is investment paralysis. It is during this stage that investors fail to take advantage of the most opportune times to buy and sell. Instead, they typically wait too long and end up executing transactions at the worst possible times.

So, how can you figure out where we are in the market cycle? Well, there are a few tell tale signs. If you are out at a cocktail party and everyone is throwing around stock tips... SELL! If you are out at a cocktail party and everybody is overcome with worry about potentially losing their job... BUY! When your taxi cab driver emphatically tells you about how he or she doubled their money this past month in the latest biotechnology company... SELL! When your taxi cab driver despondently tells you how he or she lost all of their money in the latest biotechnology company and swears off ever owning another stock... BUY! These examples were intended to be a little tongue and cheek, but in all honesty, they are really not that far off.

If you want to judge where we are within the current market cycle, look no further than fund flows from retail investors and corporations. Historically, the retail investor has shown up late to the party. Take a look at the chart below depicting fund flows from different types of clients at Bank of America Merrill Lynch (BAML).

Chart 2: YTD cum. flows by client type ($bn)



Source: Bank of America Merrill Lynch

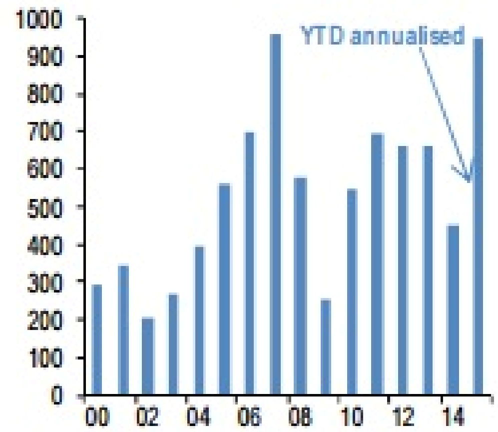
According to this data, private clients (i.e. retail investors) have been net buyers of U.S. domestic stocks through this year. Whereas, the so-called "smart money" (i.e. hedge funds and institutional investors) have been net sellers. In fact, Jill Carey Hall of BAML noted:

"Net sales of U.S. stocks amounted to $4.1 billion last week (ending June 19th), the largest total since January 2008. After three weeks of net buying, institutional clients' net sales were the largest in our data history. Hedge funds were net sellers for the ninth consecutive week, while private clients bought stocks last week following the previous week's net sales. Buybacks by corporate clients were slightly lower than in the previous week, but on a four-week average basis have generally continued at a constant pace since mid-May."

So, if institutional investors and hedge funds have been net sellers year to date, with the largest outflows among institutional investors on record occurring two weeks ago, who has managed to do enough buying to keep the S&P 500 around all-time highs? Retail investors have bought some of these shares, but certainly they don't have the fire power to absorb all of the selling pressure. As a regular reader of this column, you most certainly would've guessed... corporations! You will notice in the table below, on an annualized basis, global corporate buybacks are at the same level today as they were by the end of 2007.

Figure 1: Announced gross share buybacks

$bn per annum globally, 2015 figure reflects YTD annualized pace



Source: Reuters, J.P. Morgan calculations

If you recall, 2007 was not exactly the best time to be going "all-in" on U.S. equities and surely not the best time to be using shareholders' cash to be doing so. On an intraday basis, the S&P 500 peaked on October 11th, 2007 and bottomed on March 6, 2009. Coincidently, corporate buybacks hit a record high as the stock market peaked and buybacks hit a low in 2009, which was a level last seen in 2002 during the previous trough in the market. To say corporations are not the best market timers would be an understatement. In fact, if you just did the opposite of corporations when it comes to buying back their stock, you would have done pretty well for yourself.

I'm not saying we are headed for a year like we had in 2008. What I am saying is that caution is probably warranted. The last time corporations bought back a record amount of their stock and institutional investors sold as much as they did during the week of June 15th, 2015, nine months later the markets became unglued. Again, I'm not calling for a 57% drawdown in the S&P 500, like we saw from 2007 to 2009. But, now is not the time to be going "all-in". That time has passed for now. The prudent thing would be to assess the risk of your portfolio and make sure you are comfortable with what you own. It's not time to be complacent or fear what you may miss. Each investor has their own tolerance for risk and it would be wise to make sure your portfolio is structured to allow you to sleep at night. Buy low and sell high. It's a lot easier said than done. But, if you don't start now, you never will.

--Billy Little, CFA

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson