Playing It Safe?

The following Tony Dwyer, Canaccord Genuity Sr. Managing Director / Macroeconomist / Chief Market Strategist, Apr. 1st morning post was forwarded to us the next day by one of our DIYers:

The market is seeing a weak opening following a relief rally that still left the S&P 500 (SPX) with the worst quarterly performance since 2008 and the worst Q1 in our nation's history at down 20%. Remember, that includes a massive relief rally of roughly 17% as of Monday's close. As we highlighted earlier this week, we thought the relief rally had run its course because the three main reasons for the sharp bounce were in the rear-view mirror:

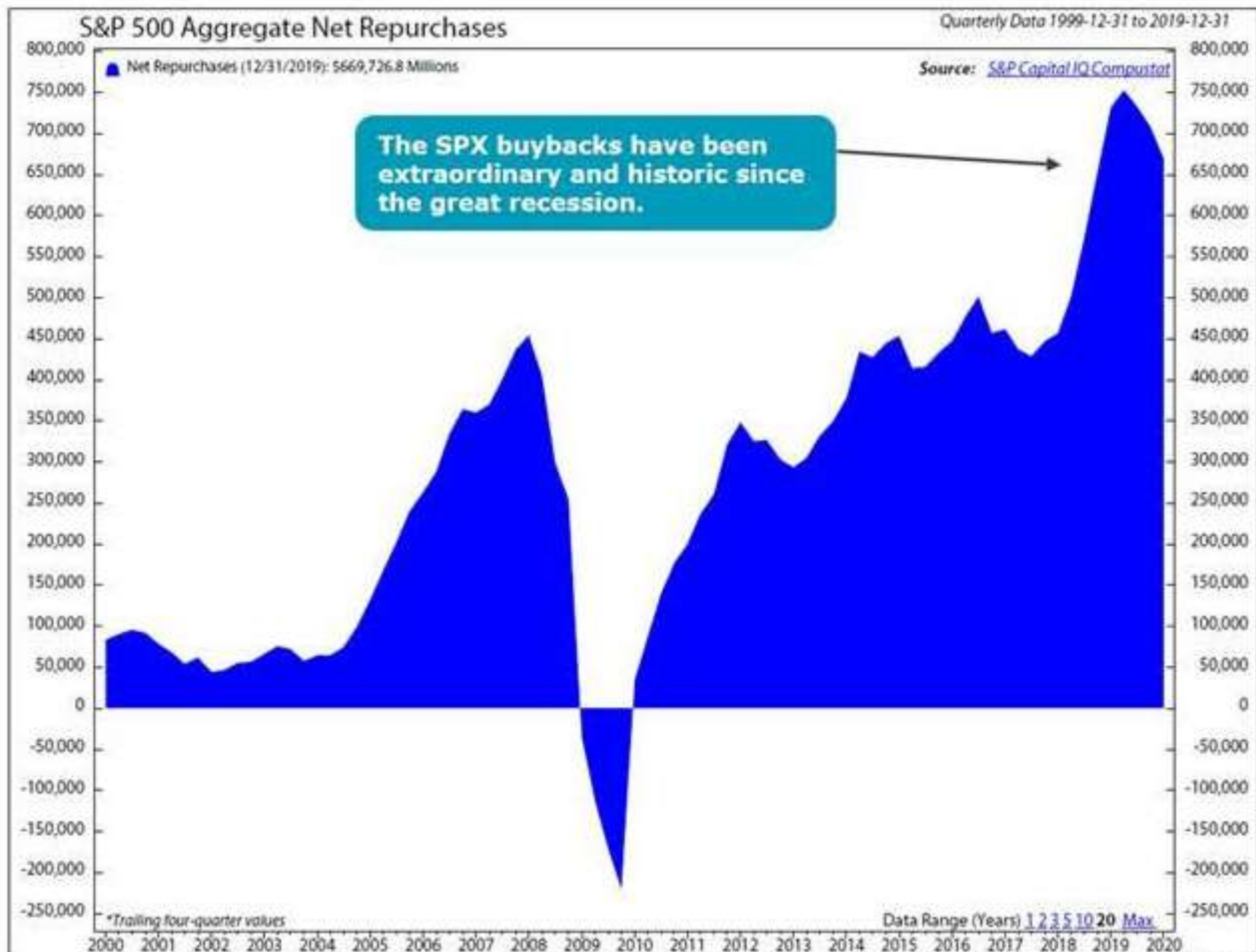
1. The market was no longer at such a historic extreme near-term oversold condition.

2. The Fed and federal government already announced their stimulus measures.

3. The pension fund quarterly rebalancing at the end of the quarter out of bonds that were up too much and out of equities that were down too much had run its course as the quarter ended.

Weakness comes as market searches for buyer. The question we now must pose is who is the next buyer to keep the market moving higher? Let's put aside the coronavirus news and President Trump's warning about the next few weeks and simply focus on supply and demand of equities. Following the historic ramp higher last

Figure 1: S&P 500 aggregate net repurchases are likely to disappear like 2008-09



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week into this past Monday: (1) Traders are taking profits on their buys since last Monday's low, (2) individual investors are stopping the spread by staying at home and trying to figure out their economic future, (3) the quarter-end pension and endowment fund rebalancing toward equities is over, and (4) most importantly, nearly every major company is preserving cash by suspending their share repurchase programs.

Demonizing the only buyer. Democratic presidential front-runner Joe Biden has called for companies to end the buybacks for the next 12 months, tweeting: "I am calling on every CEO in America to publicly commit now to not buying back their company's stock over the course of the next year." Senators Schumer, Warren, and Sanders have joined the public outcry against corporate repurchase programs. As a result, many of the largest banks, travel and leisure, and many other S&P 500 companies have suspended their buybacks programs. (We doubt that self serving political pronouncements were a significant factor in their calculations.) The problem with that is that since the Great Financial Crisis (GFC) the upside has been fueled by trillions of dollars of S&P 500 aggregate net repurchases (Figure 1), and according to Brian Reynolds of BReynolds Strategy, companies have been the only net buyer of stocks (Figure 2). (The unstated, and totally unfounded, assumption here is that if companies were somehow persuaded or, in a future Democratic administration, prohibited from repurchasing shares they wouldn't just increase their dividends, and that shareholders wouldn't turn around and buy stocks with their higher dividends.) The politicians (doubtful) and need for cash (definite) have just literally removed the only buyer from the marketplace (if "Corporations" are "the only buyer", who was buying during the "massive relief rally of roughly 17%"?) as we head into the heart of the COVID-19 crisis and economic shutdown.

Again, a test of the low doesn't mean it touches it neatly. Many times it doesn't quite get all the way back down, or it blows right through the low. Let's just have patience as we wait to see how the below factors play

Figure 2: Corporations have been the only net buyer since the GFC

Source: breynoldsstrategy / Canaccord Genuity

out as we move back toward the SPX 2300ish level and discover who the next buyer may be:

1. Stable credit markets that are not just supported by the Fed. We want to see corporate bond spreads to the 10-yr U.S. Treasuries settle down, even on weaker days, and we want to see how the draw on banks takes place as businesses remain shut down.

2. Lower volatility even on weaker periods in the market.

3. Lower correlation of the individual SPX component to the Index itself. Remember, this correlation hit an all-time high on March 23.

4. We want to see our four tactical indicators not being nearly as oversold as they were at the recent low.

Our thoughts

Here are 2 facts as noted by SentimenTrader on 4/2:

1. The past two weeks saw arguably the most oversold condition in 60 years, and
2. Then we saw the most impressive 3-day thrust in history

After another volatile week the S&P 500 closed Friday @ 2,488.65. So what do we do if we don't "move back toward the SPX 2300ish level"? As shown by SentimenTrader on 3/31, "This was clearly the case in January 2019, when the S&P went straight up." This was after the S&P 500, down 19.8% on a closing basis from 9/20/18 to 12/24/18, had barely missed a Bear Market while most indexes and foreign markets hadn't:

So what do we do if there is "**a test of the low**", but Dwyer's 4 "factors" listed above haven't been met. From 4/29/11 to 8/19/11 the S&P 500 dropped 17.6%, again on a closing basis, while most indexes and foreign markets entered Bear territory. "The S&P rallied a little more before retesting the lows:"

We understand the need for brokerage firms to "Play it Safe." **"It's difficult to make predictions, especially about the future." -** often attributed to Yankees baseball star Yogi Berra. Hopefully Dwyer will let his readers know when it is safe to buy stocks again without leaving too much on the table.