

April 26, 2021

Is A Market Correction Coming?

While our medium-term view is for the ride to continue we think a market correction is long overdue. A market correction implies a 5% decline or greater in prices from the previous peak. What are the odds we see the S&P 500 Index below 4,000, Nasdaq below 1,350, and Euro Stoxx 600 below 420? In our view, increasingly higher.

We are starting to see some signs of a potential tactical market pull-back. Economic fundamentals remain supportive to US equities, and data releases are justifying this level of optimism. PMIs show the recovery is on track, labour market dynamics are improving, and consumer sentiment is rebounding. Extremely accommodative fiscal and monetary policies are essentially creating a goldilocks backdrop for US equities. However, investors should not stay overly complacent. Historically, readings as high as the ones presented below were followed by 10% or more correction in the S&P 500. equities are priced for perfection and are vulnerable to any bad news. Last night, we got a first glance at how sensitive markets are with indices dropping in excess of 1% following the long-term capital gains tax hike on the wealthiest in the US. Negative surprises over the near-term - stemming from a growth disappointment, pandemic developments, domestic policy surprises, China's growth deceleration, or geopolitical tensions - could therefore trigger a tactical pullback. This warrants cautions over the very near-term, even if our 12-month constructive view on markets remains intact.

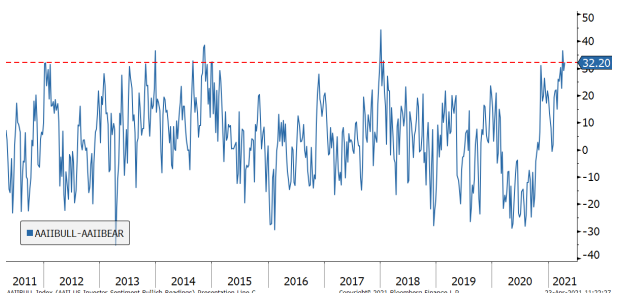
Internally, we have been discussing how extended a number of technical indicators around investor sentiment are. European equity's relative strength index runs north of 70, European HF's net exposure is at all time highs, AAll net bulls

(Chart 1) is close to a 10-Year peak, and global equity funds enjoyed record 3-month inflows.

Macro and sell-side analysts all come to the same conclusion.

Bullishness is running high. Bank of America's fund manager survey shows investors hold little cash, prompting sell signal. Morgan Stanley's global risk demand index, a good tactical warning indicator, briefly touched above +2 SD while their market timing indicator is now 50% above the sell signal threshold (Chart 2).

Chart 1. AAll Net Close to 10-Year Peak



Source. Bloomberg, MAM Research

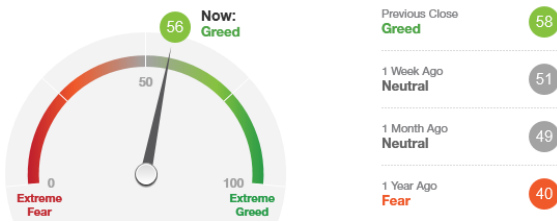
Chart 2. MS Market Timing Indicator



Source. MS Research

The BCA capitulation index (**Chart 3**) warns of a potential correction with the indicator at its highest since 1976. The complacency-anxiety indicator is rapidly climbing deeper into the complacency territory. Although it is not yet at the extremes seen in January 2018 (ahead of a 10% correction in the S&P 500), the last time it reached current levels was the summer of 2019. Subsequently, the index tumbled by more than 6%.

Furthermore, the CNN Fear & Greed indicator has gone from neutral to greed in the span of 1-month (see below).



Margin debt (**Chart 4**) continues to run at all time highs. Small caps are underperforming in a pattern similar to the one seen in the Q1 2018 (**Chart 5**). S&P 500 futures are looking over-extended, notably when looking at the gap relative to the 50DMA (**Chart 6**).

Equities are priced for perfection and complacency runs high as investors wake up to stretched valuations. US stocks may need a breather before their next leg up. We stand cautions on the tactical horizon, as any bad news can now trigger a significant pullback.

Investment Implications

In light of the short-term risk ahead, we pre-emptively hedged a portion of equity exposure through the use of derivatives. We implemented 90-100 put spreads with a June maturity using Nasdaq and EuroStoxx. We viewed this as one of the most efficient ways to approach the issue while maximizing the potential risk-reward on this tactical trade.

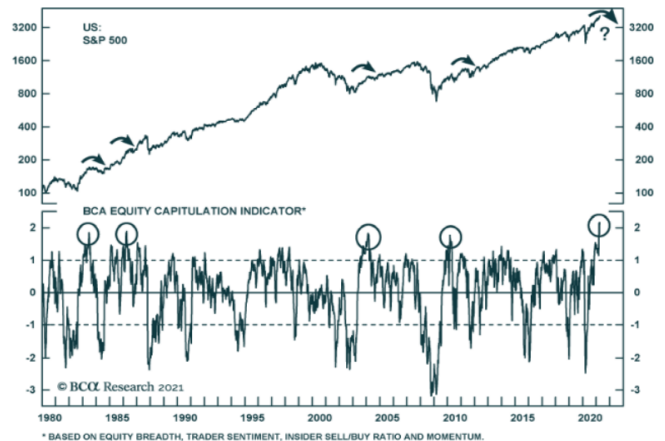
As always, feel free to reach out to use if you have any questions regarding this research.

Kind regards,

MAM Investment Team



Chart 3. BCA Capitulation Index



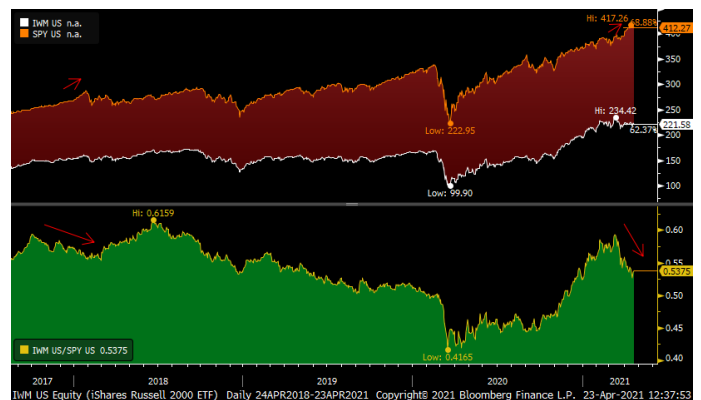
Source. BCA Research

Chart 4. Margin Debt at all time highs



Source. FINRA

Chart 5. Small Caps underperforming similarly to Q1'18



Source. Bloomberg, MAM Research

Chart 6. Small Caps underperforming similarly to Q1'18



Source. Bloomberg, MAM Research

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