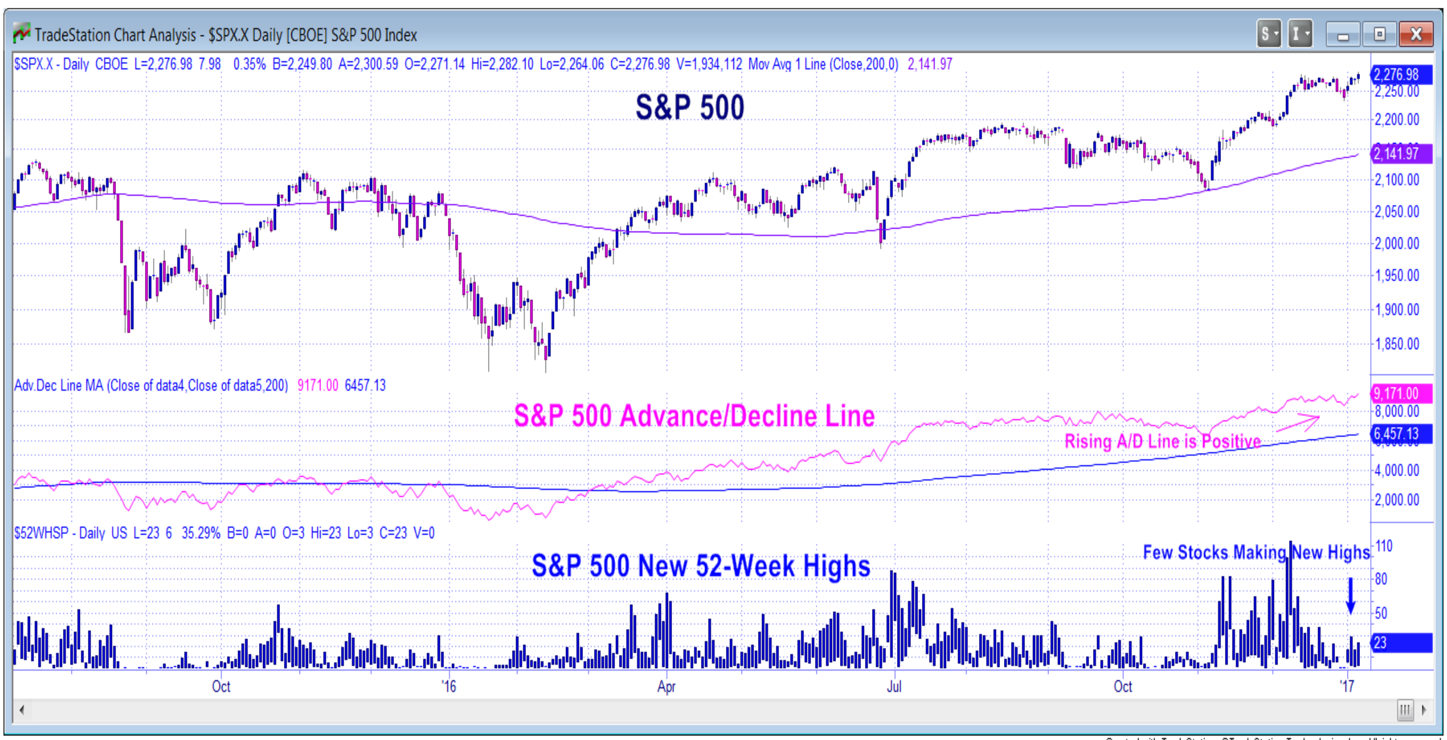
Titan Capital Management, LLC
Global Market Letter

January 6, 2017 **Abe Askil, CFP®**

U.S. STOCKS MAKING NEW HIGHS

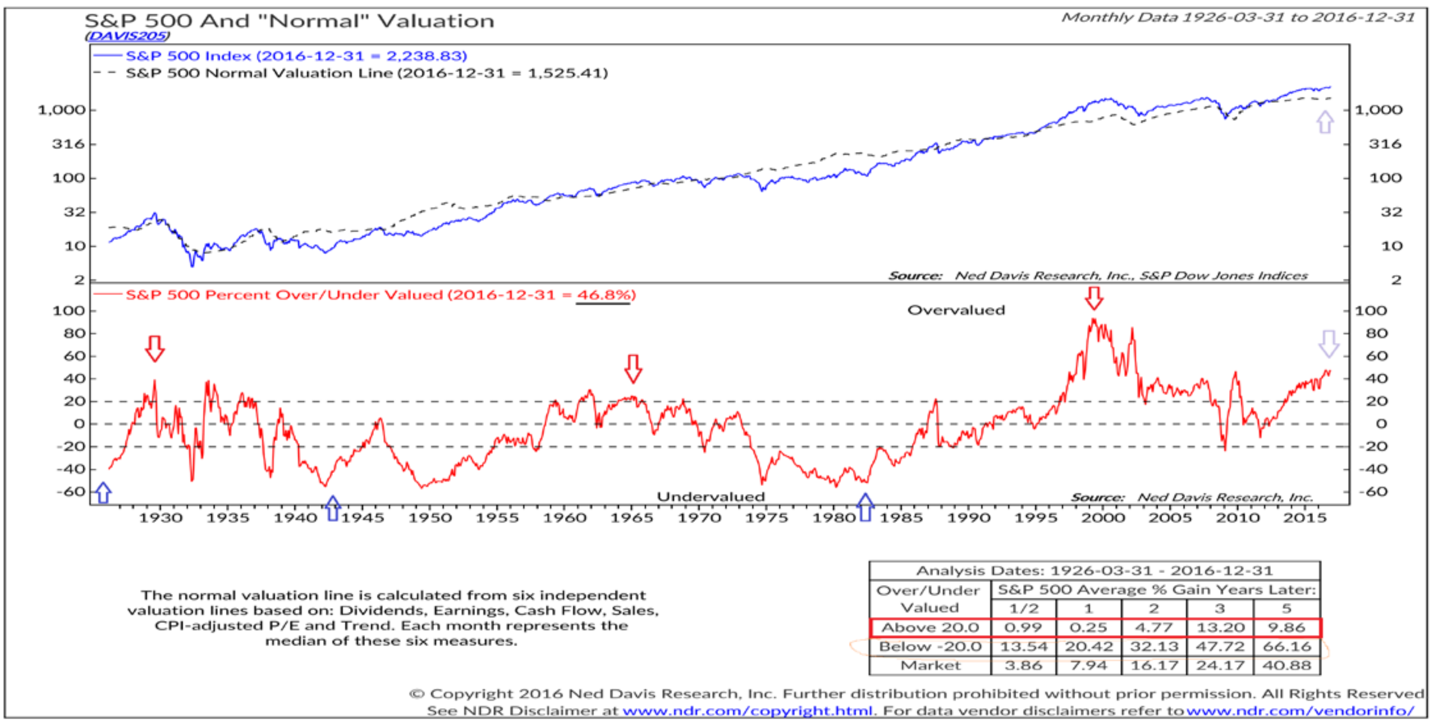
The beginning of 2016 was the worst start of the year for stocks ever with the S&P 500 down 12%. Historically, a weak start to the year has led to negative annual returns 75% of the time, yet the market defied the odds and managed to finish the year positive due mostly to one of the best post-election rallies in history. Today the Dow Jones Industrial Average, S&P 500 and NASDAQ all made new intra-day highs after trading in a range over the past 3 weeks, but they were unable to hold onto them and closed below their highs. The Dow was less than 1 point away from the elusive 20,000 level. While U.S. stock indices are making new highs, foreign developed and emerging markets are still approximately 15% to 30% away from their 2014 highs and even further away from their 2008 highs. Bonds yields, which have risen substantially since their July lows, have backed off over the past few weeks. The 10-year treasury was yielding 2.6% a few weeks ago and has declined slightly to 2.4%. As I mentioned last month, a rise above 3% could mean that the 36 year old bull market in bonds is over. One of the reasons stocks started off weak in 2016 was due to plunging oil prices. Oil is currently at $53 per barrel and if it can stay above $50 it will be positive for stocks. Gold, which was the best performing asset class during most of 2016, did not end the year well and continues its weak price action. This could of course change in the future. The start of this year is the complete opposite of last year as asset classes that started off strong last year are weak this year and vice versa.

Most of the major U.S. indices are at or near all-time highs, but market internals are currently mixed. The chart below shows that the S&P 500 Advance/Decline line is rising and reflects strong market breadth which is positive for stocks. The third pane shows the number of stocks within the S&P 500 that are making new highs. This number is currently very weak as few stocks are making new highs, which is indicative of weak participation amongst individual stocks. Historically when few stocks have made new highs it has generally led to some sort of pullback. Stocks have started 2017 on a positive note thus far, but I would not be surprised to see a pullback in the near-term given that the mixed breadth, the fact that the market is overbought short-term and excessive optimism amongst investors. There are many variables that will affect stock prices in the future such as: a new U.S. President taking office, Federal Reserve policy, economic growth, earnings growth and geo-political issues to name a few. However, as of today the stock market rally is intact.



U.S. STOCKS CURRENTLY OVERVALUED BY NEARLY 50%

It has been a while since I have written about stock market valuations. This is not because valuations no longer matter, actually the opposite. The market is more overvalued today than in any other time in history except for the late 1990's. It is very important for investors to understand that in the short to intermediate-term timeframes markets are driven by investors' emotions of fear and greed. However, in the long-term they are ultimately driven by fundamentals, and specifically valuations. The U.S. stock market is overvalued by 46.8% based on six different indicators which include: dividends, earnings, cash flow, sales, price-to-earnings, and trend. The chart below shows that in order to be at "Normal" historic valuation (black dotted line), the S&P 500 would have to decline 35% to 1525. It would have to fall even more to become undervalued. Whenever stocks have been overvalued by 20% or more (red box) they did not perform well, but when stocks were undervalued by 20% or more the returns were far better. When secular bull markets began in 1920, 1942, and 1982 stocks were undervalued by more than 50% in each case. However, when secular bear markets began in 1929, 1966 and 2000 the market was overvalued by 20% or more. The current valuation levels are where long-term bear markets have begun in the past, not long-term bull markets. Notice that there is a big difference between where the secular bulls started (blue arrows) compared to where secular bears began (red down arrows). The market is currently overvalued by 46.8%, but it is certainly possible that it continues to move higher and becomes overvalued by 60% or more in the future. The market can stay irrational longer than one can stay solvent, but one should have an exit strategy in any case.



THE BOTTOM LINE

Our trend models Alpha and Omega are both positive. We are fully invested in stocks at this time in all our strategies and comfortable being so because we are confident that our models will get us out of stocks before the next bear market arrives in full force. Since foreign stock markets are not confirming the new highs in U.S. indices and breadth is mixed, it is unclear how much further the current rally will run. We hope you all have a happy, healthy and prosperous New Year!

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