

## Say it ain't so!!!

The recent cover of Time Magazine donned a bull with a party hat, cool shades, and confetti indicating it's party time for stocks. Historically this is a bad omen. The appearance of bulls and other positive images of the stock market on the cover of national magazines have a track record of being major contrarian indicators. This has been empirically studied by Paul Macrae Montgomery who opines in Barron's this week, "If historic probabilities reliably forecast the future, there's an 80% chance the market will top in a month and will be lower a year from now." Even though the text is bearish, pictures speak louder than words according to Mr. Montgomery.



Source: <http://content.time.com/time/covers/0,16641,20130923,00.html>

I know many of our readers are probably skeptical about this "scientific" approach to market forecasting. Consider though the March 2009 cover on Time Magazine which showed a pair of hands clinging to a rope that was down to a thread. This very worrisome and bearish cover coincidentally preceded the major market bottom that very month. Another memorable example was the 1999 Economist magazine's cover story suggesting that we might see \$5 oil for the indefinite future. You guessed it, oil's bottom was near and almost 15 years later, the price of the commodity is greater than 20 times higher.

While these covers do confirm some significant turning points, we must consider that it's very rare to hear anyone point out a cover story that was in fact right. We noticed numerous rebuttals to Mr. Montgomery's historical analysis suggesting nowhere near the outcome he puts forward. We're not quite sure who's analysis to believe. Intuitively though, we believe that it's only once a trend has been in place for considerable time and widely accepted that it typically reaches the front pages of a major magazine. That's usually not the best risk/reward juncture.

Something else to consider is the cover shows a bull but the text is based on doubt and the potential for the crash to happen again. Yet, the bears have jumped all over this completely discounting the text and story and focusing only on the picture. Come to think of it, maybe this continued

disbelief is the real story we should be focused on. Markets continue to climb the proverbial wall of worry. It's felt more like the wall of disdain rather than mere worry for years now.

The excessive optimism and herd like behavior we usually see at major market tops is still not extreme. This bull market has been faced with reluctant acceptance, with lots of investors still looking over their shoulders for the 2008 financial crisis boogeyman. There have been all kinds of reasons as to why this market could not continue to go up over the past five years, but it has.

Thankfully our process does not depend on predicting short term stock market moves. It is based on investing capital in the most favorable risk/reward opportunities at any given time. Currently, it is more challenging to do so. High quality sound businesses continue to get bid up. Take for example the shares of Johnson & Johnson. The mega-cap US healthcare company has generated significant gains over the past number of years. Recently though, the trajectory has gone vertical, a time to be cautious. Today the shares trade at a P/E (LTM) of 21 times versus 13 times five years ago.



Source: Stockchart.com

The valuations of many quality companies we review today are pricing in continued good times ahead, in many cases too good. In 2009 share values overshot to the downside, as this market progresses they may overshoot to the upside. We wouldn't be surprised to see a pause and potentially a material one in the marketplace. We're not convinced though that a major top is being put into place. After all, even in the picture this poor bull is partying by himself! We remain defensively positioned as we think we are likely closer to last call than the hor d'oeuvres. But as we saw again this week, as long as the Fed keeps filling up the punchbowl investors will keep the party going. The hangover from this going on too long could be nasty.