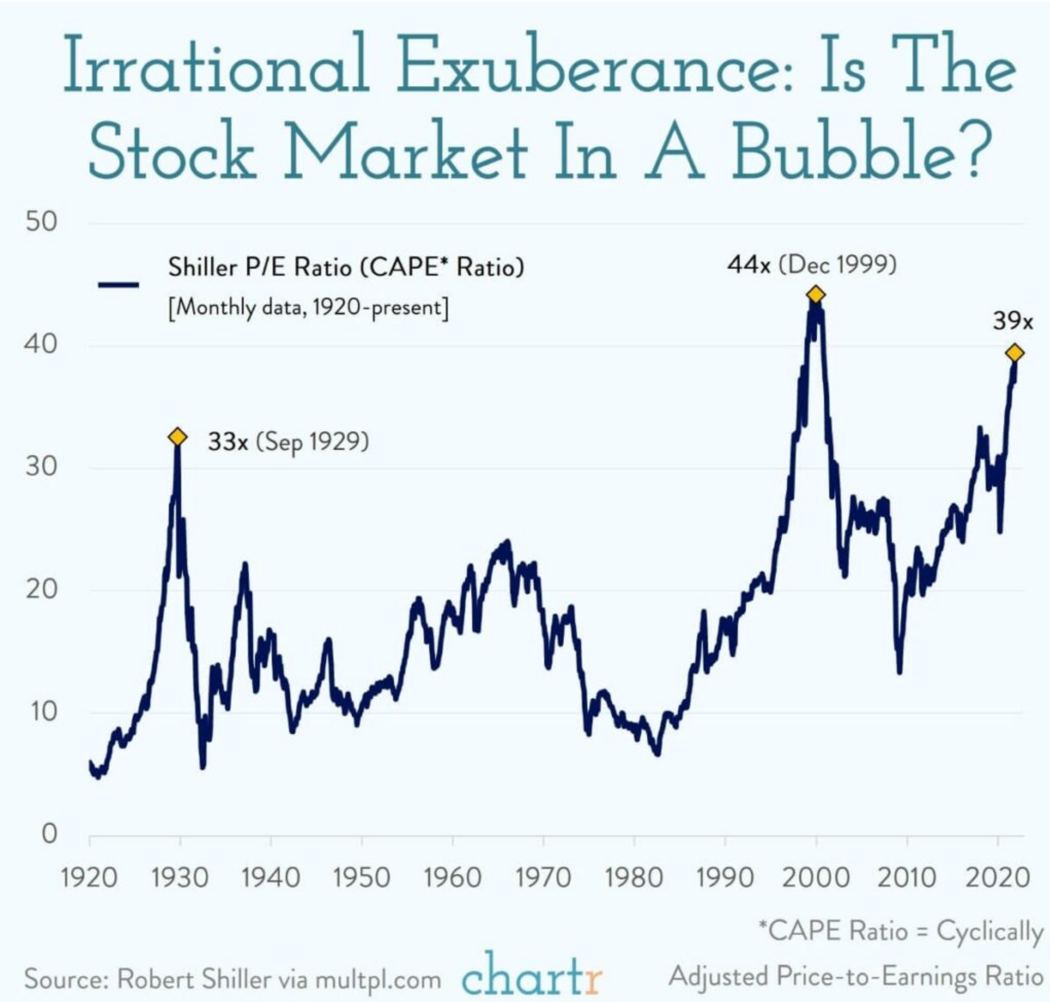
RIA Advice

Bulls Push Stock Market Valuations To Extremes

The S&P 500 *"buying"* stampede continues, pushing stock market valuations to extremes. As of Friday, the Shiller PE valuation rose above 40. As noted in ***"Did The Fed Set The Market Up For A Crash,"*** current valuations now dwarf that seen in 1929 and only bettered by the latter months of 1999.



While the stock market rallies, pushing valuations higher, there are concerning signs a peak may be near. For instance, the VIX volatility index is higher. Typically stocks and volatility are negatively correlated. Thus, at the rare times when they do move upwards in unison, a reversal in stock prices is expected.

[dmc]

What To Watch Today

Economy

- *No notable reports scheduled for release*

Earnings

Pre-market

- 6:30 a.m. ET: **Coty Inc. (COTY)** to report adjusted earnings of 3 cents on revenue of $1.36 billion

Post-market

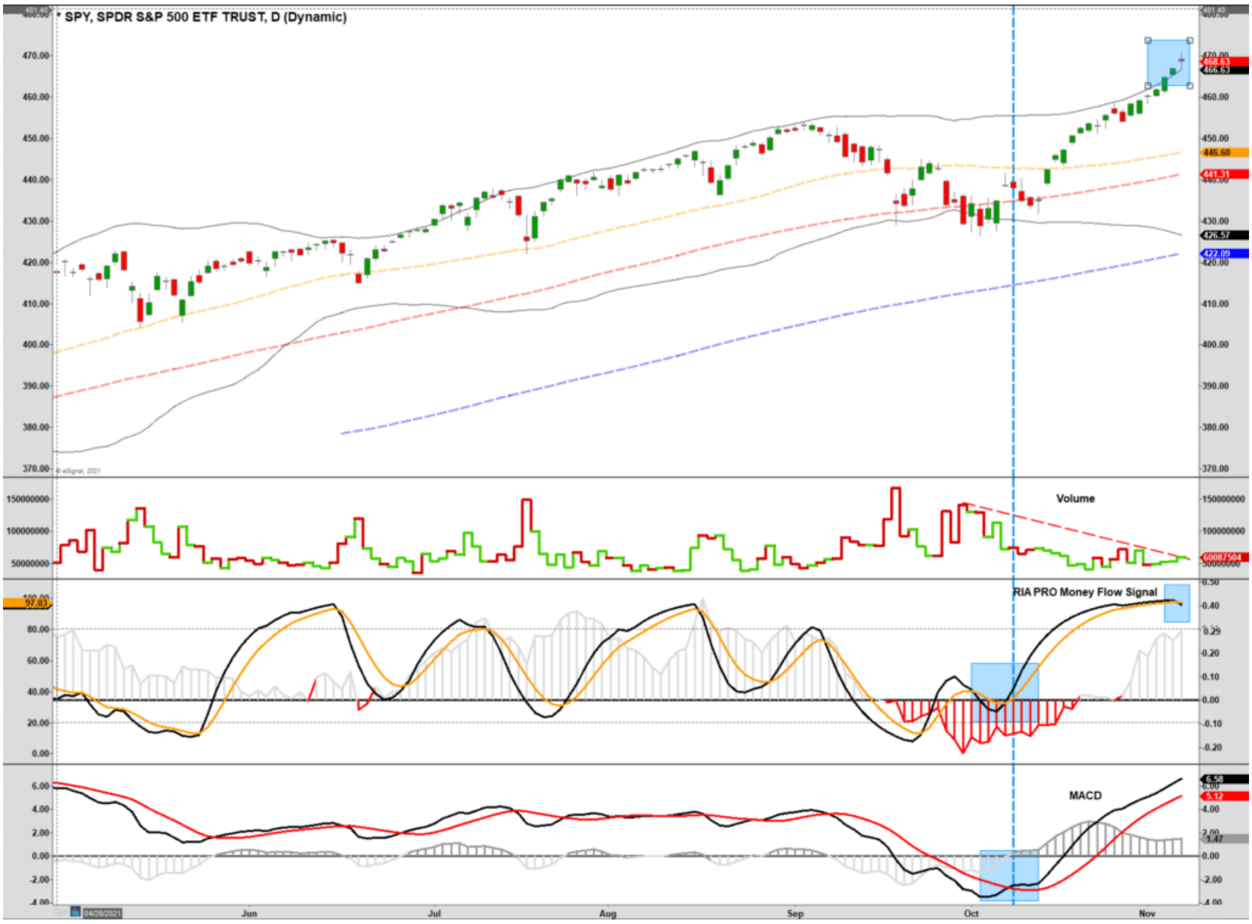
- 4:00 p.m. ET: **Roblox (RBLX)** to report adjusted losses of 19 cents on revenue of $639.86 million
- 4:00 p.m. ET: **SmileDirectClub (SDC)** to report adjusted losses of 12 cents on revenue of $185.09 million
- 4:05 p.m. ET: **Virgin Galactic (SPCE)** to report adjusted losses of 29 cents on revenue of $1.83 million
- 4:05 p.m. ET: **Zynga (ZNGA)** to report adjusted losses of 53 cents on revenue of $708.25 million
- 4:05 p.m. ET: **TripAdvisor (TRIP)** to report adjusted earnings of 24 cents on revenue of $303.5 million
- 4:05 p.m. ET: **Clover Health (CLOV)** to report adjusted losses of 23 cents on revenue of $338.67 million
- 4:05 p.m. ET: **The RealReal (REAL)** to report adjusted losses of 49 cents on revenue of $113.73 million
- 4:15 p.m. ET: **PayPal (PYPL)** to report adjusted earnings of $1.07 on revenue of $6.23 billion
- 4:15 p.m. ET: **AMC Entertainment (AMC)** is expected to report adjusted losses of 53 cents on revenue of 708.25 million
- 4:35 p.m. ET: **Lemonade (LMND)** to report adjusted losses of $1.16 on revenue of $33.81 million

Courtesy of Yahoo

Market Back To Extreme Overbought

In the short-term *"valuations"* matter little to the stock market. The more significant concern to the remains the underlying technical condition of the market. While the rally has been impressive, rising to all-time highs, the market is now back to more extreme overbought levels.

Furthermore, our *"money flow buy signal"* is near a peak and slightly triggered a *"sell signal*." **However, with the MACD still positive, the signal suggests a consolidation rather than correction.** However, a confirming MACD often aligns with short-term corrections at a minimum. Therefore we will watch that signal closely. **Also, this entire rally from the recent lows has been on very weak volume, which suggests a lack of commitment.**



Demand For Put Options Falls To Low

As we have noted previously, stock market valuations, by themselves, are a terrible timing metric. However, they tell us a great deal about expected future returns and current market psychology.

When it comes to ***"irrational exuberance,"*** there are other indicators better at revealing speculation in the markets that have preceded a stock market crash.

The CNN Fear/Greed index is now at extreme greed territory.

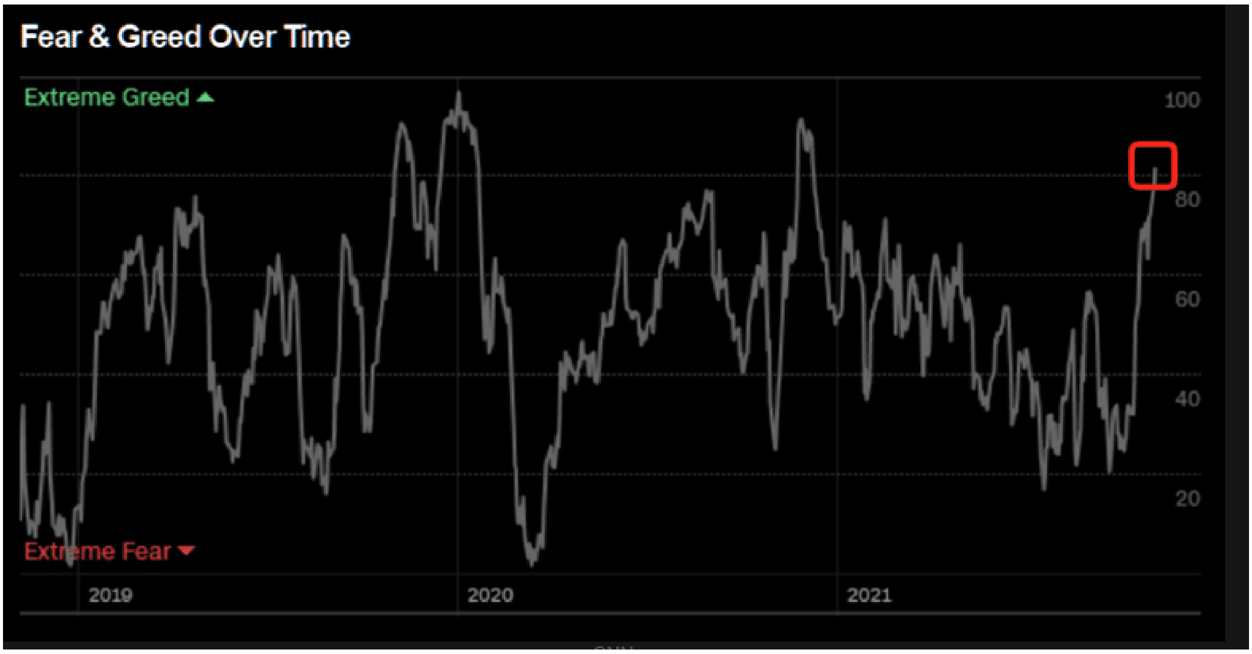


Chart courtesy of TheMarketEar via Zerohedge

Furthermore, the demand for protection against a stock market crash *(put options)* fell to new lows.

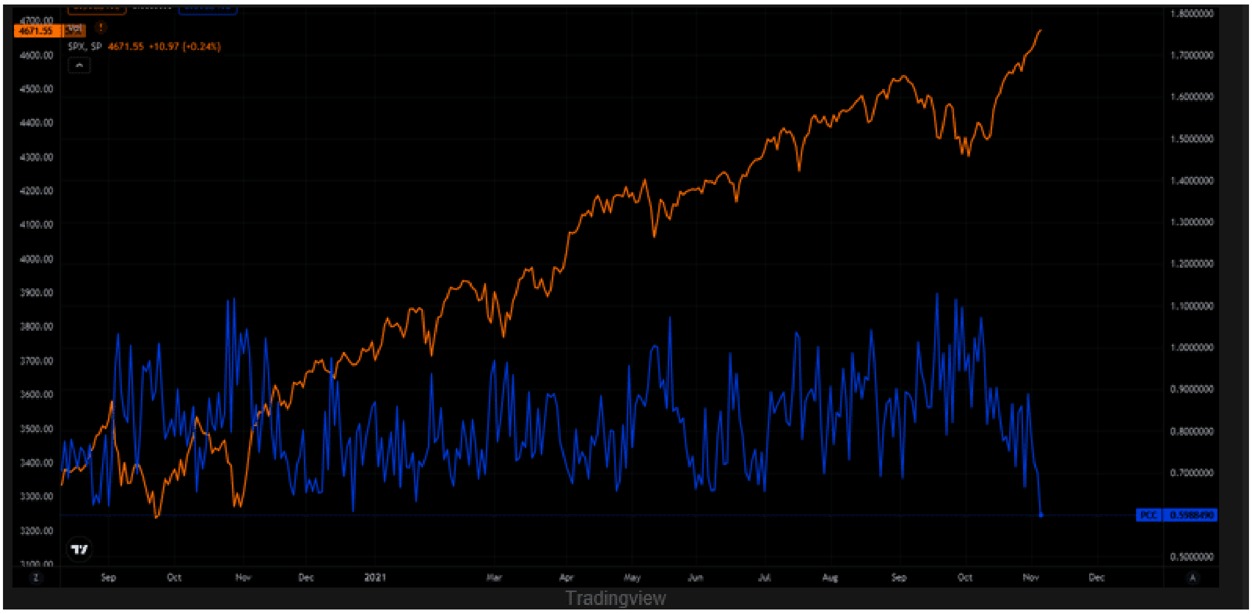


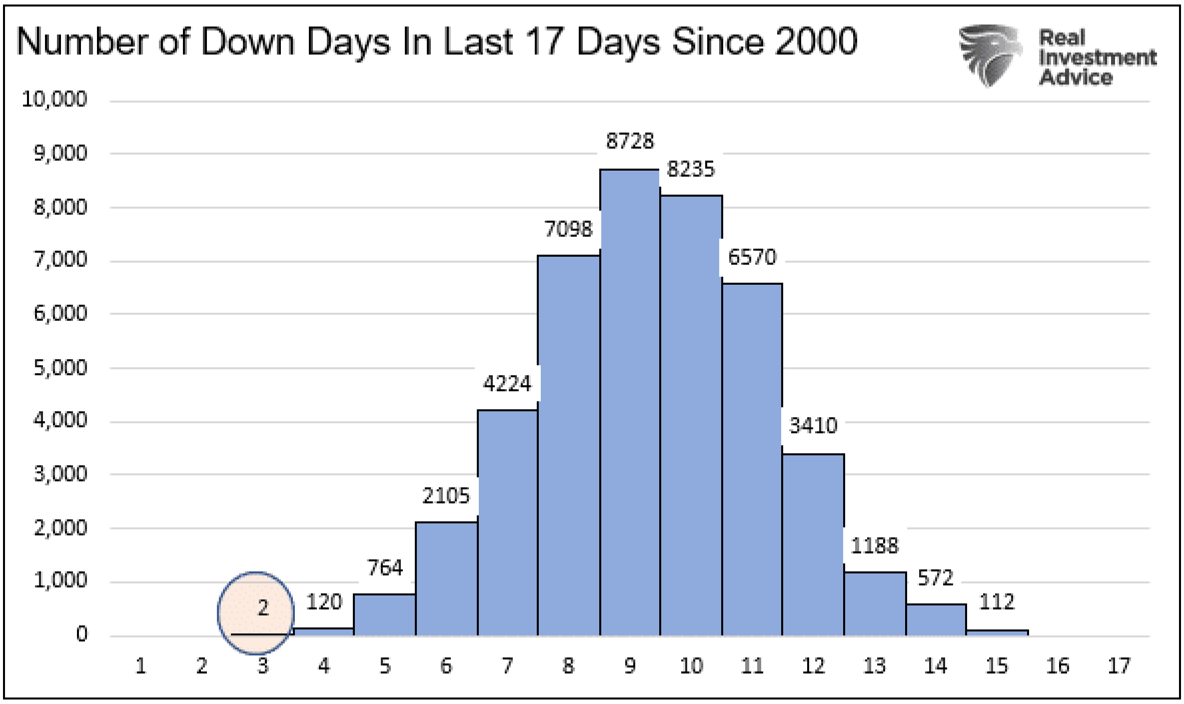
Chart courtesy of TheMarketEar via Zerohedge

Historically, such periods of *"speculative"* activity led to a minimum of short-term stock market corrections, but a crash is not beyond the realm of possibilities.

S&P 500 Record-Setting Streak

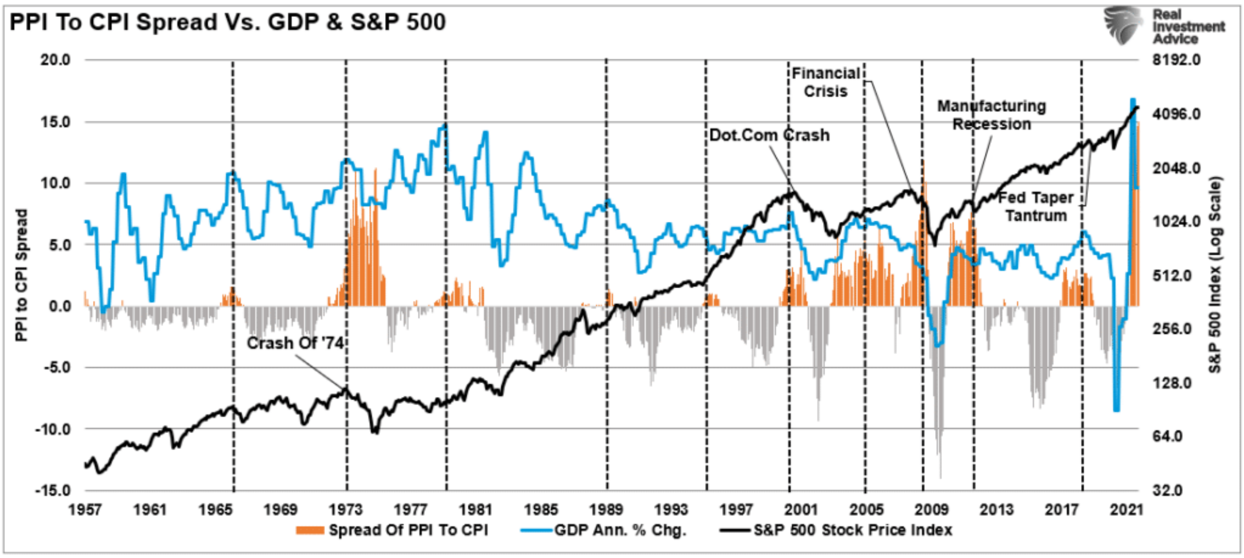
Currently, the bulls control the market as we are in the middle of a *"buying stampede."* Historically, buying stampedes last on average between 7 and 12 days. **Logically, buying stampedes always get followed by selling stampedes of similar lengths.** However, there are times these stampedes can last much longer than expected.

We are currently in one of those longer-term periods. As shown below, **the S&P 500 has only been down in 2 of the last 18 days**. How unusual is that? **In the previous 20-years of the S&P 500, the number of times the market accomplished such a feat was precisely ZERO.**



Producer Price Inflation Versus Consumer Price Inflation

Currently, with PPI at the highest spread to CPI in history, it suggests producers can't pass on costs to customers. Such equates to weaker profit margins and earnings in the future. However, if they elect to pass those costs onto consumers, such will raise living costs well above wages.



As Michael noted last week:

> ***??Promoting the stability of the financial system? seems to be an unofficial mandate.*** *Might the Fed be dragging their feet to reduce crisis-driven policy because they fear a stock market crash? More specifically, can extreme stock valuations be justified without an overly aggressive Fed?*
>
> *The latest Fed meeting makes it increasingly clear that monetary policy changes are more a function of the asset markets and not the Fed?s congressionally stated*

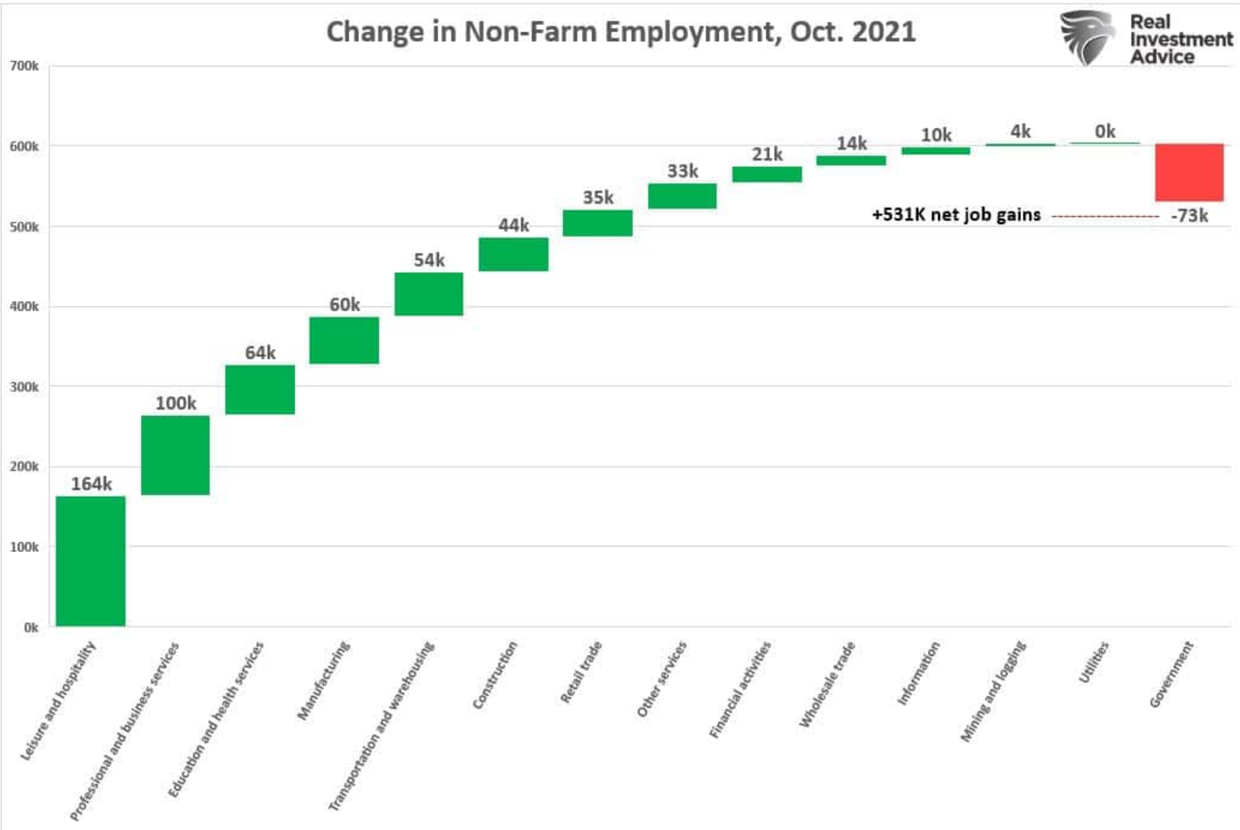
mandates.?

The Fed's choice to ignore inflation risk is likely unwise. Previous spikes in the inflation spread aligned with weaker economic growth, stock market contractions, or crashes.

The BLS Employment Report

As foreshadowed by Wednesday's ADP report, the [BLS payrolls report](#) was strong. 531k jobs were added in October, bringing the unemployment rate down to 4.6% from 4.8%. The prior two months were revised higher by 235k jobs. Monthly average hourly earnings slipped from +0.6% to +.04%, but wages rose 4.9% versus 4.6% on a year-over-year basis. The average workweek declined by a tenth of an hour, surprising given the strong demand for labor. Jerome Powell's key figure, the labor participation rate, was unchanged from last month despite the strong job growth. During his post FOMC press conference, he mentioned on numerous occasions that he would like to see the participation rate rise before entertaining rate hikes.

The graph below shows October's employment gains or losses by industry. As shown, leisure and hospitality added 164k jobs to the economy, accounting for almost one-third of the new jobs. The government sector was the only sector to lose jobs.



Ripples In Still Water

On the surface, yesterday, the most followed stock indexes gave the appearance of just another healthy market rise. The S&P was up 20 points and the NASDAQ up 1.25%. The tech sector carried the weight with semiconductor stocks, notably being the best performers. However, beneath the surface, there are ripples. The heat map below shows over half the stocks in the S&P 500 were down on the day. Also of concern, the VIX volatility index rose 5%, bond yields fell sharply, and gold was up 1.75%. Divergences and poor breadth are worth watching as they can signal a change in direction. Our models are alerting us to overbought conditions, so a drawdown would not be surprising.