

Morning Tack - "Selling Into a Vacuum"

So, yesterday we were swamped with phone calls and emails about the current state of the equity market. Accordingly, we dialed up one of our best friends who manages money at a large Boston-based mutual fund. He confirmed what have been hearing and writing about recently. To wit, hedge funds typically send out letters on November 15 advising their investors they have a six-week "window" to pull their investment funds from said hedge funds. That is exactly what is happening now, as the guess is 150 hedge funds will close their doors at the end of this month. Combine that with the long-only mutual fund liquidation, and tax loss selling, and what is happening is that participants are selling into a vacuum of NO BUYERS. Indeed, at this stage, not many folks are willing to step up and buy, because the PMs would not only be "betting" their performance record and their bonuses, but ultimately, their jobs. That's a bet few are willing to make. We did receive this from a NYC based PM late yesterday:

"Pension Rebalancing Model estimates there will be ~\$90bn inflows to Equities and out of Fixed Income from pensions over December month end, the 95th percentile since 2005 and the largest estimated inflow to equities since May 2012."

And, that feels about right to us. We continue to believe this decline is due to the Mueller investigation and the aforementioned "selling into a vacuum." When it ends is unknowable, but selling stampedes tend to last 17-25 sessions, and today is session 13 in the skein. Speaking to the current selling squall, our friends at Bespoke had this to say:

"Bullish sentiment among individual investors has tanked to its lowest levels in more than a year as stock prices have declined. The spread between bulls and bears is the most negative it has been since 2016. Over the intermediate to longer term, these prior drops in sentiment have set the stage for above-average returns going forward.

The fundamentals remain decent with bond yields declining, oil prices have rolled over, the Chinese trade talks seem to be quieting down, Italy has a budget agreement with Brussels, the fear and greed index readings are as fearful as they ever get, and valuations are the cheapest they have been in half a decade. Still, in selling stampedes, rationality goes out the window. As Chesapeake watermen say, "You can't change the direction of the wind, but you can adjust the sails!" We adjusted the sails in early October, but we should have rigged for heavy weather!

As for the numerous emails we have received about support levels for the S&P 500 (SPX/2467.42), here they are by our pencil: S&P 500 Index support: 2460, 2446, 2428, 2417, 2400, 2380, 2360, 2134. This morning the preopening futures are lower again (-13 points) as general Mattis resigns stating:

"Because you have the right to a Secretary of Defense **whose views are better aligned with yours on these and other subjects**, I believe it is right for me to step down from my position."

And our Florida Senator Marco Rubio states: "It makes it abundantly clear that we are headed towards a series of grave policy errors, which will endanger our nation, damage our alliances, and empower our adversaries."

Of course this has left the futures lower as the government gets ready to shut down . . .

"Jeff, 150 hedge funds are going to close their respective doors by December 31, 2018."

. . . A well-known portfolio manager at a Boston-based mutual fund

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	22859.60	-464.06	-1.99%	-7.52
Dow Jones Transports	4559.27	-47.63	-1.03%	-10.16
Dow Jones Utilities	729.42	2.66	0.37%	0.84
S&P 500	2467.42	-39.54	-1.58%	-7.71
NASDAQ	6528.41	-108.42	-1.63%	-5.43
Russell 2000 (Smallcaps)	1326.00	-23.23	-1.72%	-13.64
BKX (Banking)	84.09	-0.39	-0.46%	-21.20
BTK (Biotech)	4097.21	-88.39	-2.11%	-2.96
XOI (Oil Index)	1144.45	-29.42	-2.51%	-14.31
SOXX (Semiconductor)	1117.74	-9.70	-0.86%	-10.80

Key Commodity Prices	Last	Net
Crude Oil WTI (NYM \$/bbl) Continuous	45.630	-0.27
Gold (NYM \$/c)	1262.900	-5.20
Silver (NYM \$/ozt) Continuous	14.745	-0.12
United States Dollar Index	96.577	-

Market Valuation	2017	2018E	2019E
Consensus S&P 500 EPS	\$132	\$161	\$174
P/E	18.7	15.3	14.2

Treasury Yields	90D	10 Yr	30 Yr
	2.39	2.78	3.01

Source: FactSet. Data as of 12/21/18 6:54 a.m.

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* Columns may not add to 100% due to rounding.

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