Dear Clients,

I love old Wall Street sayings. Some of these date back to a time when a stock's last sale was recorded on a chalkboard. The trading floor has mostly been replaced by computers zapping buy and sell orders back and forth at light-speed, but the driving force behind the beast known as "the market" ultimately is human, and human nature doesn't change very much. Here are some of my favorites:

1. Bull markets climb a wall of worry; bear markets slide down a river of hope--Unknown
2. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell—Sir John Templeton
3. We simply attempt to be fearful when others are greedy, and to be greedy when others are fearful—Warren Buffet
4. The stock market will always do whatever makes the greatest number of people look foolish--Unknown
5. Those who know don't tell, and those who tell don't know—Michael Lewis
6. A stockbroker is a guy who knows the price of everything and the value of nothing (love this one!)--Unknown
7. There is always free cheese in a mousetrap (my personal favorite)--Unknown

Then there is the Efficient Market Theory. This Nobel Prize-winning theory holds that markets are perfectly efficient: Every piece of available information about a stock is reflected in its price in real time. No one person can gain an edge, and therefore stock selection is pointless. Therefore, according to the Efficient Market Theory, it is better to invest in mindless index funds and match the market, which tends to goes up in the long-run. But index funds are not so mindless. Index funds are cap-weighted; largest market cap stocks make up a disproportionate share of the total. As these stocks may grow to larger and larger values (think Facebook, Amazon, Netflix, Google), they begin to dominate the index. Investors who blindly shovel money into the S&P 500 by definition are overweighting the parts of the market which have done the best in the recent past, and underweighting the parts that have done the worst—not exactly buying low and selling high (see saying #2).

So which saying is most applicable to today's market? Saying #1 definitely applies today. We are in a bull market, so is it climbing a "wall of worry"? Let's see, is there anything out there to worry about? Subpar economic growth for nine years. Political dysfunction and gridlock. Global tensions: North Korea, the Middle East, Russia, Brexit. The decline of the middle class. Downsizing. Outsourcing. Record Federal debt. The Federal Reserve's bloated balance sheet. The list goes on and on. So yes, there is plenty of 'worry' left to climb. Conversely, this is a bullish sign.

If the public is so enamored with the stock market, why are they pulling money out of mutual funds and ETFs? According to the Investment Company Institute*, which tracks these flows, investors pulled $11 billion OUT of mutual funds and ETFs during the first weeks of July, even though markets are near all-time highs. This doesn't strike me as 'maximum optimism'. Some might say that all this cash is dry powder to fuel future gains as these reluctant investors scramble to get back in.

I can't finish without citing an example of saying #7, "free cheese". What is free cheese? Obviously something which is too good to be true. Lately there has been an explosion in trading of penny stocks, particularly those purporting to cash in on the marijuana industry. There have been price increases on the order of one hundred times what these things were trading for a year ago. Investment newsletters and websites scream tantalizing buy recommendations—for the price of a subscription. Then there is Bitcoin, and the more recent "crypto-currencies" promising vast wealth. How many of the people taking the plunge into this investment netherworld have any idea what they are buying? Looks like free cheese to me.

Please feel free to email us with comments and questions.

Regards,

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*SentimentTrader 7/13/17