INVESTMENT NOTES - March 18th, 2019

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It appears as though we could be 'melting up'. Price acceleration is a key indicator of such a phase, more so than pure price or value, and with the recent market gains in the U.S. and China it appears melting up has a higher probability than a melt-down. Retail investors are racing back into the markets to help fuel the move.

Investors from all over the world seem to be preparing for a melt-down and they are unprepared for the possibility that they are wrong and it's a melt-up that will dominate the next decade. This is the proverbial 'wall of worry' that markets so often climb. Most strategists are calling for a market correction since the first two months of 2019 were so strong and investors have a long list of worries: earnings downgrades, government closure, China slowdown, US/China trade issues, European banking problems, Brexit problems, budget deficits, socialism rising, debt piles, North Korea talks breakdown, etc. However few are talking about the retail investor racing back into the markets, high levels of cash and strong leverage momentum, the fact that companies are not just looking at buybacks but looking at investing in the real economy with new technology, governments that are not just spending on QE but defense and cyber, China's Belt and Road initiative, etc.

This said, any stock market melt up might quickly turn into a melt-down if socialist mandates are implemented including: Modern Monetary Theory (MMT), +70% marginal tax rates for the wealthiest, Green New Deals costing US$50-90 trillion, Universal wages, Sen Elizabeth Warren's Accountable Capitalism Act, Sen Cory Booker's Worker Dividend Act, etc.

Unfortunately real capitalism which is about risking your own capital, being creative, and innovating has been clouded by the the Fed or Treasury bailing people out if it doesn't work. This leads to privatized gains but socialized risk which isn't what capitalism is. Capitalists need to stand up to cronyism and bring back the meritocracy that was replaced. However, now- there is just too much money and too much innovation for everything to stop.

Therefore this bubble, like all bubbles will be different. What we need to ask ourselves is whether investors are getting clearly carried away? Are prices accelerating? Is the market narrowing? And are at least some of the early warning signals from previous bubbles falling into place? For one- previous bubbles have increased at least 60% in the previous 21 months- this would be 3700 on the S&P 500 and would be consistent with a melt-up phase. If this does occur, then the probability of a melt-down is very high. However a massive drop probably won't signal the ending of the longest bull market in history. This decline will not look like the Japanese bubble of the late 80s, the EM crisis of 1997/98, the tech crisis of 2000 or the housing crisis of 2008 or even the Bitcoin bubble, but will limp along with three steps down and two steps back.

Therefore when our shorts fall as Tenneco did last week, we cover. When stocks are providing long-term, innovative value, we buy. Warren Buffett's saying that we don't know who is swimming naked until the tide goes out, could be a metaphor in both melt-downs and melt-ups.

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