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By Greg Gann

Important Underneath the Hood Data

Opinions, as they say, are like one's derriere; everyone's got one. There is an incessant amount of talking heads postulating as to where market prices will go. Most of them are talking up their holdings, and are therefore biased and non-objective. I subscribe to multiple sources of objective, unbiased research. One of these is from Lowry Research Corporation. Lowry is strictly a research organization. It has no dog in the fight. It makes no forecasts, but rather objectively measures supply and demand. And, it has an eighty-eight year history doing so. Plus, Lowry has examined every major market top going back to and including the Great Depression. It has consistently found patterns, and these patterns have resurfaced within the past year.

Lowry has identified that market tops are deceiving and very difficult to pinpoint for the average investor. The reason for this is that the major indexes such as the S&P 500 are typically not crumbling and showing signs of deterioration even though such deterioration is brewing underneath the surface, and is not visible within the raw data of the indexes. What I mean by this is that a recurring pattern that develops through the making of a market top is that the price of the index is being upheld by fewer and fewer companies. Although the S&P 500 ended modestly down for the 2015 calendar year, so much of the index was supported by merely four stocks-Facebook, Apple, Netflix, and Google, (the so-called FANG stocks because of the acronym). For example, Netflix increased a whopping 134.38% in 2015 and Google "A" surged 46.61%. Also, the index was down a lot earlier in the year than where it ended after the Santa Claus rally.

Although the U.S. stock market indexes have not yet evidenced significant price losses, Lowry's measurements of the forces of supply and demand are demonstrating a very different picture. From December 31, 2014 to December 31, 2015, Buying Power decreased from 255 to 175, resulting in a loss of 80 points. Selling Pressure also significantly increased over the year. The established pattern in the formation of market tops is that price changes first impact stocks in the small-cap space. Then they move to the mid-cap. And then finally they are experienced amongst the large-cap players. True to form, Lowry calculated that the number of small-cap stocks that were trading within 2% from their highs at the end of 2015 moved from 14.38% to 3.33%. For mid-cap stocks this percentage deceased from 23.24% to 15.53%. And for large-cap stocks the percentage fell from 27.10% to 17.45%.

Furthermore, a bear market correction is commonly defined as a loss of 20% or greater. In 2015, the percentage of small-cap stocks that were in bear market territory increased from 39.05% to 61.71%. For mid-caps, this number increased from 18.06% to 34.36%. And for the large-caps this percentage moved from 8.87% to 19.81%.

All of this is to say that you can't judge a book by its cover, and that there is more going on underneath the surface than most of the prognosticators or talking heads realize. The bull market that has been fed with easy money, low interest rates, and major credit expansion has become exhausted. The strategies and types of investments that have been conducive during the bull market cycle emerging from the depths of the financial crisis are unlikely to prevail over the next cycle. Moreover, bond funds which have ameliorated returns even during bear market cycles over the last 35 years will also likely contribute to losses during this cycle as interest rates reverse their nearly 35 year pattern and now increase. I do not feel that this is a time for long-only stock and/or bond fund investing. Different market conditions demand various game plans. Let me know if you'd like access to our plays. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.