Financial Insyghts

What We Do

Most economists think of confidence as a consequence of human action. Financial Insyghts believes the opposite: Our level of confidence determines our preferences and, in turn, our decisions and actions. Even more, our level of confidence transcends all that we do, simultaneously too. Finally, confidence is entirely forward-looking. It is about how we see ourselves succeeding in the future. As financial markets share that same forward-looking behavior, by understanding specifically how changes in confidence alter human behavior, it is possible to better understand the markets, particularly at major turning points.

For more than five years, Financial Insyghts has analyzed the relationship between confidence-driven behaviors outside the markets with what is happening inside the financial markets. Today, those insights are shared with major money managers and hedge funds enabling them to deploy *thoughtful tactical asset allocation ™* - using non-market indicators of extremes in confidence to improve investment returns.

For example, in early August 2011, Financial Insyghts noted the "coincidental" spontaneous riots in London with the plummeting FTSE as a low risk entry point for investors.

Coincidence?

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Then later that fall, Financial Insyghts wrote:

It's Around Here Somewhere – *In the context of the book I am writing on how social mood affects our decision making, I have been spending a lot of time looking at market bottoms and the behavioral patterns that accompany them. While I will spare you the gory details, I'd offer that much like market tops reflect a confidence level I can only describe as "self-assured certainty", market bottoms are filled*

with "self-assured uncertainty", where hopelessness and helplessness not only abound, but are viewed to be a permanent condition.

With this as background, I'm going to go out on a limb to suggest that there is a bottom nearby. Whether that bottom happened near 1070 on the S&P on Tuesday or will happen shortly at a level below – or even well below – that level, we'll see; but to these eyes there are reflections of self-assured uncertainty everywhere I look.

Over the past week Forbes ran a column by British historian Paul Johnson entitled "Who Can Lead Us To Safety" while last Saturday Joe Queenan's column in the Wall Street Journal was headlined "Who's Our Daniel Boone or Joan of Arc?" And even The Economist jumped on the "rudderless" bandwagon with its cover recommending "Until politicians actually do something about the world economy…BE AFRAID".

And then there were these comments from Moody's on Wednesday:

"There has been a profound loss of confidence in certain European sovereign debt markets, and Moody's considers that this extremely weak market sentiment will likely persist…It is no longer a temporary problem that might be addressed through liquidity support, and several euro-area governments are increasingly affected by the loss of confidence."

Put simply, certainty has been lost and is not coming back any time soon and we see no one who can rescue us from the deep end of the pool. Be afraid. Or at least that is what we now think.

The problem I have with all of this is that both tops and bottoms are defined by saturation. And of late, everyone from parents on the sidelines at soccer games to media pundits is talking about it. Europe has fallen and can't get up and we all now know it.

I suspect that in the next week or so we will finally see a coordinated action that beats our now lowest expectations. Despite their rhetoric to the contrary, European leaders are not deaf to what is going on around them. But unlike 2008, our poor social mood now requires that policymakers react to the crisis after bad things have actually happened, rather act on pre-emptive basis and risk second guessing by the voters.

But once again, I'd note that whatever we see will represent Europe's Pat Benatar moment. They will hit us with their best shot. But please appreciate today how mediocre that best shot needs, and thus is likely, to be. At this point anything not bad will be seen as good.

In the short run this may cause the market to bounce as our self-assured uncertainty morphs into something more akin to doubtful. But the idea of our social mood reflecting confidence, let alone self-assured certainty is years off.

Please appreciate that here we are at 1100'ish on the S&P, barely down into a bear market – and 10% higher than we were last summer – and we are already lamenting a crisis of confidence in global leadership. And with these leaders now likely to do just the bare minimum to keep things afloat, when mood deteriorates anew, I am afraid that what we all think of as "self-assured uncertainty" today will take on a far more depressing, or should I say Depression-like, feel.

As long time investors know, early October 2011 marked a major US equity market low.

In July 2012, Financial Insyghts offered these thoughts on interest rates:

How Low Can You Go? – *Yesterday, the FT offered this thought, "The US borrowed for 10 years at the lowest rate ever in Wednesday's auction, (technically a reopening of an existing bond)…investors who were able to submit direct bids got their hands on a huge – record – amount of the total, around 45 per cent. The scale of demand at the auction suggests investors expect US interest rates to remain low for several years."*

I realize that I am a very lonely with my belief that Treasury yields have bottomed, but whenever I see words like "record", clear investor extrapolation and phrases like "to remain low for several years" the hair on the back of my neck goes up.

At tops and bottoms in the market we believe that current conditions are permanent and with regards to the US Treasury market this feels like one of those moments.

From my perspective the most likely scenario for the US Government bond market is what I would best-describe as a pivot with 2-3 year and beyond Treasury yields rising and shorter term yields going negative – with T-Bills carrying as much as a negative 1-2% annualized yield.

Why this scenario?

Deflation

On the very short end, investors will seek T-bills as a proxy for physical cash, and longer out the curve they will worry about the long-term creditworthiness of the US Government.

I realize that this is a peculiar if not extreme scenario, but looking at the current political, economic and social landscape, I'd offer that "peculiar" and "extreme" both fit.

More recently, in mid-August 2013, Financial Insyghts offered these observations on Egypt:

Turmoil – *Once again the news headlines from Egypt are tragic. The situation there seems to be going from bad to worse. Interestingly, though, that is not what the stock market there shows:*

While clearly the market has sold off over the past week, it is still up more than 20% from its late June lows.

One might ask, "How can this be if things are deteriorating so dramatically there?"

The situation in Egypt is a great case in which understanding confidence as "cause" rather than "effect" is so helpful, particularly at bottoms in confidence.

Bottoms, particularly very deep bottoms in confidence are consistently marked by acts of sacrifice, and as I have shown before, most major Middle East terrorism events, including September 11th, occurred at major bottoms in the Egyptian market index.

The June bottom in the Hermes index (and the EGPT ETF) coincided with the military coup and ouster of the Morsi government – a very dramatic act of sacrifice. While the country is now engaged in a civil war, please appreciate that wars follow bottoms in confidence/market bottoms. They don't lead them.

While I am not saying that the Egyptian market can't go lower from here, this week's Economist cover, like the two back-to-back covers which the magazine ran as the market was bottoming in late-June, suggests that negative sentiment is reaching saturation.

As counterintuitive as this may seem, to those looking for an uncorrelated market position, Egypt represents a very low risk opportunity given where confidence there is today.

At the end of August 2013, Financial Insyghts shared these thoughts:

Wednesday's Child Is Full of Woe – *Even before I checked the futures market, I knew that Wednesday was going to be a significant day in the markets. The Wall Street Journal's headlines all but oozed negative social mood:*

> *"U.S, Allies Prepare to Act As Syria Intelligence Mounts"*
>
> *"Leaker's Security Check Faulted"*
>
> *"Powered by Outrage at the IRS, The Tea Party Makes a Comeback"*
>
> *"More Young Adults Live With Parents"*
>
> *"Housing Prices Cool As Loan Rates Rise"*
>
> *"Yellen, Summers Both Worth Millions"*
>
> *"Dolphin Die-Off Blamed On Virus"*
>
> *"Texas Church Is Center of Measles Outbreak"*
>
> *"Uneven Election Success for Black Politicians"*
>
> *"States Win In Fight for Withheld Payments"*
>
> *"Cultural Rift Spurs Secession Drive in Colorado"*

And those were just the headlines through page four!

As offered before, the media follows mood; and based on what I saw, sentiment Wednesday morning was particularly grim.

Not surprisingly Wednesday delivered the "V" shaped turn I had been watching for in both the Indian rupee and the Sensex, along with a bottom in most other emerging markets. (And yet again, this week's low confidence in the emerging markets brought with it a flurry of "reactive" central bank actions.)

But note this chart of the EEM, the major emerging markets ETF:

Note how this week's low is higher than the late June bottom. Despite very negative sentiment and saturating media coverage - with comments like "'It's hard to see the end of the tunnel' for India" (WSJ) - we now have a higher low for the EEM. While never eliminating the potential for a broad scale global market collapse, I believe that we are at a very low risk entry point for emerging markets. (And to my comment on the miners from last week, I would note this week's goodwill write-off news out of Australia's fashion retailer Billabong. June's low social mood in Australia was clearly very widespread. And in that regard, I must apologize for not highlighting the June 26th ouster of Australia's first female Prime Minister, Julia Gillard, ***by her own party****. Talk about a perfect social mood set up for a market turn!)*

In mid-September 2013, Financial Insyghts noted this:

Driving Miss DAY-Z – *I have made no secret of my concerns regarding the growing bubble in the ultra-luxury world. This week, let me add yet another log to the fire: SUV's.*

To provide a little context on my concern, here is a little history of the luxury SUV market courtesy of Wikipedia:

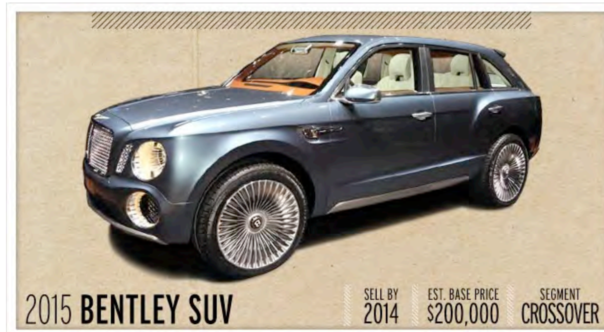
> *"[The Luxury SUV] marketing category was created in 1966 with Kaiser Jeep's luxurious Super Wagoneer. It was the first SUV to offer a V8 engine, automatic transmission, and luxury car trim and equipment in a serious off-road model. It came with bucket seating, air conditioning, sun roof, and even a vinyl roof. Land Rover followed suit in 1970 by introducing the Range Rover. The trend continued with other competitors adding comfort features to their rudimentary and truck-based models.*
>
> *The production of luxury models increased in the late-1990s with vehicles such as the Lincoln Navigator (1998) and Cadillac Escalade (1999)."*

1966 was a major market peak in the US markets. The UK (and US) markets experienced a major peak in 1969. We are all well aware of the 2000 market peak.

While not exact, there is a pretty clear almost 50-year correlation of luxury SUV launches and market tops.

To that point, this week, I saw this news report:

"Rolls-Royce Motor Cars Ltd., the ultra-luxury carmaker owned by Bayerische Motoren Werke AG, is considering a sport-utility vehicle, following Bentley's lead in the race to make the world's most exclusive crossover.



'We are intensively thinking about entering the SUV segment,' Rolls-Royce Chief Executive Officer Torsten Mueller- Oetvoes said in an interview at the International Auto Show in Frankfurt.

A Rolls-Royce model in the segment could cost more than the first SUV from Volkswagen AG's Bentley, which will go on sale in 2016 and is set to cost about 180,000 euros ($240,000). Rolls- Royce's

cheapest cars sell for about 250,000 euros.

A Rolls-Royce SUV would be part of an upmarket shift for a vehicle style that became popular because of its high-riding position and ample storage space. Fiat SpA's Maserati plans to start production of the Levante SUV in 2015. Jaguar showed a crossover concept at the Frankfurt show.

'The SUV segment is very interesting,' Mueller-Oetvoes said. 'It has been incredibly stable during the crisis, and I think a luxury niche will develop.'

COURTESY: MASERATI

Rolls-Royce is beginning the evaluation by having designers draw up sketches as a first step in deciding whether a SUV fits the brand. A decision is open, Mueller-Oetvoes said."

Talk about saturating "riding high" sentiment: Coincidental ultra-luxury SUV launches by Rolls Royce, Bentley, Masterati and Jaguar.

They may not ring the bell at the top, but they sure honk the horn.

In December 2013, Financial Insyghts offered these thoughts:

To Every Action – This week Bloomberg reported that President Obama will sign into law "the first bipartisan budget produced by a divided Congress in 27 years." While others see this as bullish for the 2014 economy, I cannot emphasize enough what this says about political generosity, and therefore confidence.

Further I would note that the bipartisan pressure to curtail the NSA also speaks to the same peak in confidence. Governments' willingness to trample Constitutional rights ebbs and flows with confidence. That there is agreement on both sides of the aisle to "curb NSA spying" reflects very high confidence.

Finally, I would not discount the significance of the William Morris/IMG merger. In my August 2nd Commentary, (the same day the S&P peaked before declining 5% over the next four weeks) I noted:

"To these eyes the oversized Omnicom/Publicis [merger of equals] is trumpeting euphoria in the advertising space. And looking at the recent moves in stocks likes like Facebook, YELP, Google and even beleaguered Yahoo, it is not a just a trumpet duo, but a full brass marching band on steroids. The moves and valuations are remarkable.

While I wish the extraordinary enthusiasm in the marketing world was bullish for both the markets and the economy as a whole, I am afraid that the ebullience I see suggests caution, if not extreme caution. If history holds, not only will the specific Omnicom/Publicis deal be a disaster, but the entire sector is at

risk. And given the interweaving of advertising with the real economy, I am afraid that much more than just on-line click-through ads are in jeopardy.

While the popular line suggests that the market doesn't ring a bell at the top, the M&A world does with wedding bells. What we have just witnessed is a royal wedding. While investors appear to be enjoying the reception, I'd be on the lookout for wedding crashers. They are out there, and after they help themselves at the open bar, the party could get really rough."

This week William Morris announced that it was buying sports marketing firm IMG after a lengthy bidding war. Sports and confidence go hand in baseball glove and to see two iconic firms come together, particularly two iconic firms whose business is itself representing icons, also speaks to high confidence.

Every week Financial Insyghts scours the world around us for non-market indicators of confidence and shares those observations with its clients. As many of those observations run counter to the group think seen on CNBC and Bloomberg Television, Financial Insyghts clients benefit from meaningful non-market contrarian indicators - Something no other organization offers in real time.

For organizations looking to complement their existing economic and Wall Street research with a unique, unbiased view of confidence-driven human behavior, Financial Insyghts offers a range of solutions.

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