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When the cookie will crumble in the USA market?

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A DIGITIAN Group Company

When the cookie will crumble in the USA stock market ?

USA stock market is the mother of the Global Stock markets, very advanced, deep and diversified and has main trade cycles, booms and busts over a centuries. Further, It can be called as true reflection of Global market as most of the major companies listed in other markets of the world are also cross listed in the New York Stock Exchange (NYSE) or Nasdaq commonly referred as wall street. Moreover, there are thousands of Exchange Traded Funds(ETFs) run by Investment Bank, Hedge Funds etc and real Estate Investment Trusts(REITs). Through these ETFs/REIT and cross listed shares, major part of the globally important stock markets are controlled by USA Investors. This is the reason why any sneeze in USA creates cold in other markets across the world. At present if you are operating in any market of the globe then you need to understand the dynamics of USA stock markets and keep close track of its pulses.

It is a common topic in the main street nowadays given the all Time High level of US Stock Indices for the last decade since low at 2008 financial crises (refer Table 1) – when the market crash is expected. There are three main indices the analysts around the world follow S&P Dow Jones Industrial Average (DJIA), Nasdaq Composite (Nasdaq) and S&P 500. However serious players follow mostly S&P 500 and Nasdaq and not much mutual funds/ETFs money ride on DJIA. As per S&P it is only USD 36 billion linked to DJIA in comparison to USD 9.9 trillion is linked to S&P Index. All these Indices are showing overwhelming growth in the last 10 years: DJIA (12.05% pa) Nasdaq (23.36% p.a.) and S&P 500 (11.94%) --- the growth percentage are more for last 5 year or 3 Year and even last 1 year. Thus, there is no doubt that considerable heat in the US stock markets due to this long bull run.

Table 1 : Ten years performances of USA stock Indices

US Stock Indices	CMP	1M	3M	6M	1 Y	3Y	5Y	10Y
DJIA[1]	25090	24706	24610	24754	21394	17620	14909	11378
		1.55%	**1.95%**	**1.36%**	**17.28%**	**42.40%**	**68.29%**	**120.51%**
Nasdaq[2]	7747	7352	7482	6995	6165	4986	3403	2326
		5.37%	**3.54%**	**10.75%**	**25.66%**	**55.38%**	**127.65%**	**233.06%**
S&P 500[3]	2780	2711	2747	2676	2432	2063	1067	1267
		2.55%	**1.20%**	**3.89%**	**14.31%**	**34.76%**	**160.54%**	**119.42%**

As on 18.05.2018 DIGITIAN Global Consulting Research

Note : 1 The **Dow Jones Industrial Average** (**DJIA**), since 1885, consists of 30 large, publicly owned companies based in the United States. It considers share price of component companies as weigths instead of their market capitalization,

2. The **NASDAQ Composite**(**IXIC**) since 1971 consists of all listed components exclusively on the NASDAQ stock market (over 3000 companies) and is heavily weighted towards information technology companies. The index is however 90% influenced by sub index Nasdaq 100.

3. The **Standard & Poor's 500**, (**S&P 500)** since 1957, consists of 500 large companies having common stock listed on the NYSE or NASDAQ on the basis of their market capitalization. It is one of the most commonly followed equity indices, considered as best representations of the U.S. stock market, and a bell weather for the U.S. economy.

4. Russel US 2000 and 3000 Indices reflects the performance of small cap companies in USA but this is not analyzed.

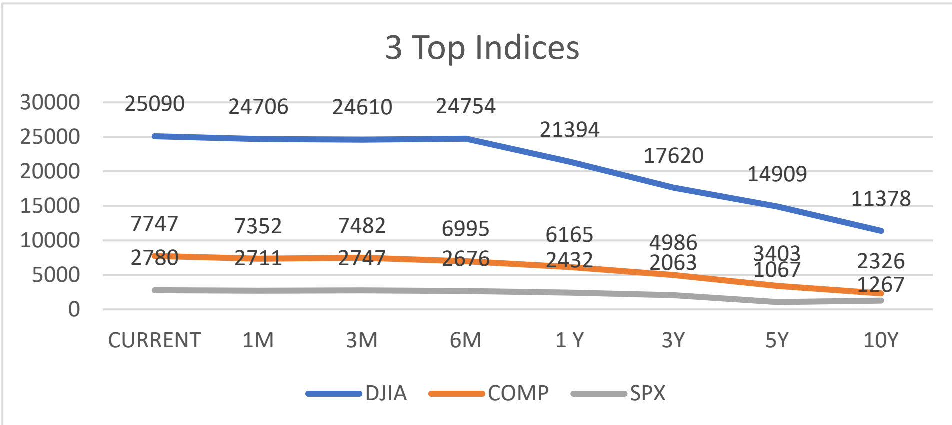
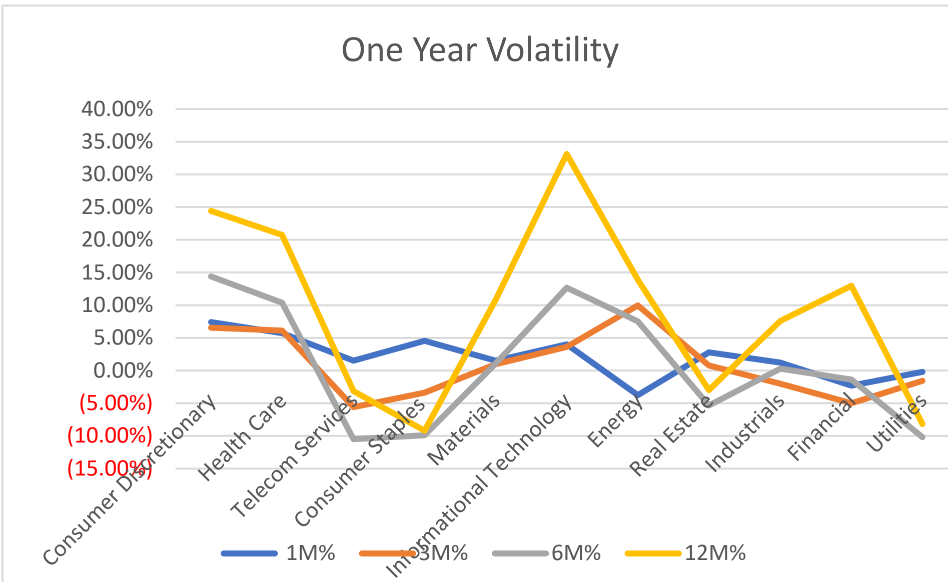


Chart 1

The chart shows the major gain by the large 30 stocks in the USA market (DJIA) of this bull run followed by bull run in the technology stocks in NASDAQ 100. While S&P 500 reflects the mixed bag of stocks of all sectors. Secondly, we need to understand the depth of USA stock market. It covers 11 broad sectors as captured in Table 2 with over 68 subsectors and over 42214 components listed (common stock, American Depositary Receipts (ADRs), Limited Partnership Interests, Ordinary Shares, Real Estate Investment Trusts (REITs),Shares of Beneficial Interest (SBIs), Tracking Stocks, ETFs, Closed end Funds etc). In the last 12 months although Indices have shown growth but it is not across all sectors and across all time periods. Many of the sectors have been completely under bear run. Please refer **Table 2**

	Sector	**S&P 500 %**	**COMPANIES**	**1M%**	**3M%**	**6M%**	**12M%**
1	Consumer Discretionary	13.52%	7390	7.41%	6.55%	14.39%	24.40%
2	Health Care	13.74%	3661	5.72%	6.13%	10.39%	20.75%
3	Telecom Services	1.70%	431	1.52%	(5.59%)	(10.50%)	(3.16%)
4	Consumer Staples	7.56%	3046	4.56%	(3.40%)	(9.90%)	(9.20%)
5	Materials	7.56%	3046	1.49%	0.98%	1.07%	10.82%
6	Informational Technology	26.51%	6267	4.03%	3.61%	12.67%	33.11%
7	Energy	5.91%	2117	(3.76%)	9.96%	7.52%	13.90%
8	Real Estate	2.64%	2029	2.76%	0.77%	(5.34%)	(2.98%)
9	Industrials	9.74%	7973	1.20%	(1.99%)	0.30%	7.58%
10	Financial	13.48%	5145	(2.33%)	(4.99%)	(1.40%)	12.96%
11	Utilities	2.63%	1109	(0.21%)	(1.57%)	(10.19%)	(8.19%)
(Source: DIGITIAN Global Consulting Research)			**42214**				

Thus, it requires in-depth professional technical analysis on a daily basis to identify the areas of opportunities. **Broadly, even within the overall "Bull runs" there are sectors and subsectors which are witnessing bear runs.** In case of a particular subsector, share prices of more than 50% of the companies will be in 52 week lows while the overall sector is showing the bullish trend. As such, normal value estimation (fundamental and technical Evaluation) of each and every company is critical (first order condition) but not sufficient, **the most important factor of making money from the bull and/or bear markets is the composite understanding of subsectors, its role in the economy, global trend and overall buoyancy of the sector it represents.**



Source : DIGITIAN Global Consulting from Saugata's Value-volatility Multiplier

Chart 2

This charts shows the first level importance of Volatility in switching holding pattern of portfolio from one sector to another sector depending upon the trend. Very few sectors has consistently done well in all four time intervals. Some sectors like consumer staples which were not doing well started doing well in the last 1 month. While Energy which were doing well in 12m and 6m and 3m nose dived in the 1 month period and same volatility is noticed in case of Financial doing very good in terms of 12m but did not do well in 6m/3m/1m. **This provides a certain support that market correction may be still few quarters down but the markets will go through this topsy-turvy trend.**

Third, Multiples (Price Earnings/price to Book are abnormally high :

This really shows the heat. Most of the performing stocks are trading at a very high P/E which really shows that there will be a correction around the corner. Take the example of **FANG stocks** (Facebook, Amazon, Netflix and Google) or Twitter many other new age stocks in Health care, Consumer Discretionary as summarized in the Table 3

Table 3

Stock Name	1 year Growth	Price to Book Value	Price-Earning
Face Book	31.25%	7.6x	29.7x
Amazon	74.62%	26.9x	275.6x
Netflix	168.83%	45.1x	264.7x
Google	21%	5.1x	31.76x
Twitter	159.46%	6.6x	84.1x

Over 50% of the stocks in top percentile to their 52 week High has P/E ratio higher than 30x. On this count, a significant correction is technically forming ahead. It is a digital boom, and in language of **Alan Greenspan**, former Fed Governor, a case of **"Irrational Exuberance".**

Fourth, another early warning signal is coming from US Fed interest rate hike which has impacted the **long-term treasury yield curve**, in particular, the "spread" between yields on long-term and short-term debt. Unlike the normal situation if short-term yields rise above long-term yields. Spreads turn negative. According to **Porter Churchouse of Stansberry Research, history shows that these inverted yield curves are often followed by a recession and a major bear market in stocks.** The most commonly used one is the "2-10" spread -the simple difference between the yields of benchmark 10-year Treasury notes and two-year Treasury notes. The 2-10 spread has been falling steadily since February 2018, and just hit a new post-financial crisis low of 0.35% in June 1st week. The other significant one is "7-10" spread, this implies the spread between 7- and 10-year Treasury curve yields. As Bloomberg reported on June 19 2018, The "7-10" spread slipped to 3.5 basis points and is expected to inversion by June end.

It is important to keep track of the yield curve “7-10” spread inversion for the first level warning signal followed by “2-10” spread inversion. A cautious trading approach is the order of the day preferably in a Low Beta stock backed by a regular strong technical analysis to identify the bullish and bearish trend and trade with a lower stop loss and with a target price.

In conclusion, Warren Buffet’s Quote can be aptly repeated. There are two rules in the stock market one should strictly follow:

Rule 1 : Do not loose money in the stock market

Rule 2 : Do not forget the Rule 1.

DIGITIAN is a neologism and refers to a Digital generation in particular those who born in or after 2000. The first version of this generation is completely different and they will rule the world from 2018 – 2075. Be ready for them.

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