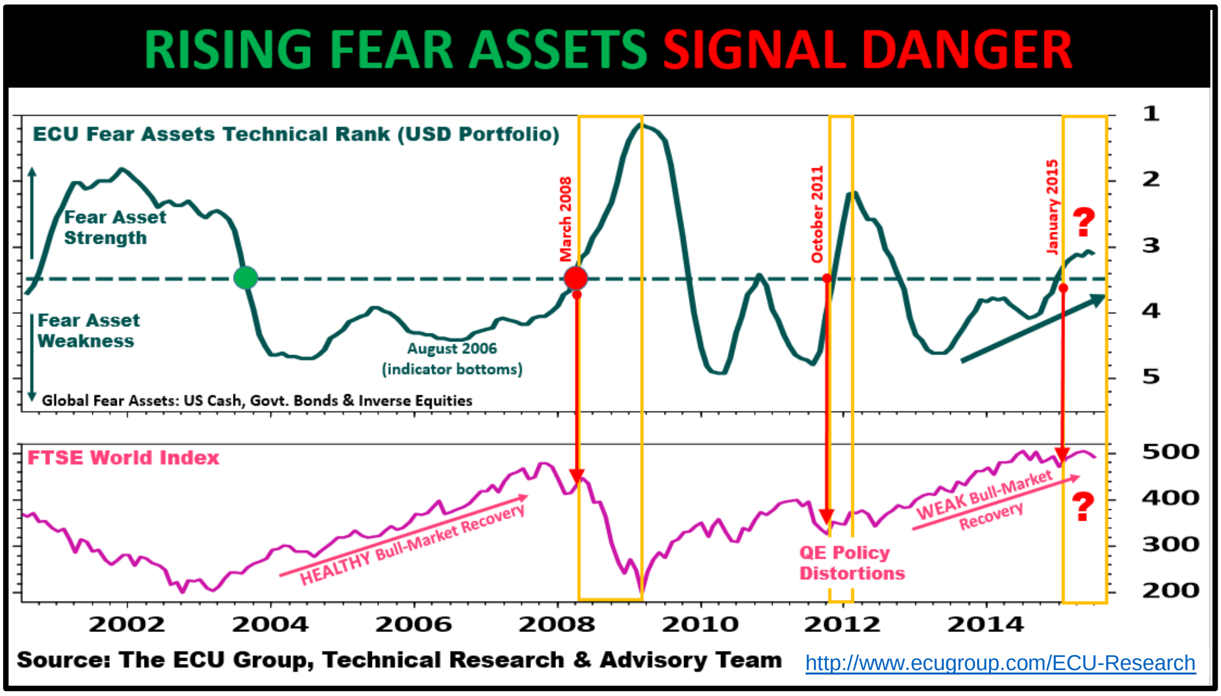
Rising Fear Assets Signal danger

“The only thing we have to fear is fear itself” Franklin D Roosevelt

When we analyse World Assets, some can be considered to be ***Greed Assets* and others *Fear Assets*.** The first typically do well in bull markets and bubbles. The second outperform in bear markets and crashes. In a bull phase we would expect **cash and inverse equities, or short selling, to perform badly.** When we rank the trend strength of all asset classes into quintiles, from strongest to weakest, these two assets would rank at the bottom of the weakest quintile. As time evolves, and the bull phase becomes mature, they will slowly move up the ranking order**. This is like a “heads up” signal, but not the sign of a top.** Once they rise into the strongest quintile, however, they are signalling danger. We have made an indicator out of this process and show it expressed in terms of US dollars.



You will observe from the chart above, the first time the Fear Indicator crossed upwards through the trigger line was in September 2000 and the next cross upwards was in March 2008. By studying the S&P 500 Index overlaid, we can see that this **occurred just after the top of the markets and was followed by a steep bear move in US Equities.** The third time this happened in late 2010, the signal failed, but for a very good reason. The Fed came in with massive Quantitative Easing designed to prevent an equity market meltdown. It worked and a modest weak bull period followed. The next time this happened – in 2012 – another round of Quantitative Easing was initiated.

Troublingly, the same signal has emerged again. However, it is widely expected that the Fed will not do any more QE and instead remains on course to raise rates this year. **As long as they do not deviate from this policy, the signal is negative for the market.** It clearly shows **that investors are no longer being punished for**

holding excess levels of cash, and those that sell short are better placed than a year ago.

Fear assets in dollar portfolios are winning now so either we are **in the beginning of the end of the US equity bull market or the throes of the bear market.** In any case, the indicator is signalling that the **risk-reward of investing in US equities has deteriorated significantly and investors should be risk averse if not actually afraid.** The question is whether the Fed and other Central Banks can come up with other reflationary alternatives – even if they are called something other than QE?

On a final point, in the "Old Normal", Government Bonds would be classed as Fear Assets as they were widely regarded as the safest asset available. However in the "**Brave New World", post QE, this asset class has now become so distorted that it may well be the most dangerous asset class of all.** We continue to include them in the Fear Indicator, but may have to drop them if they no longer preserve capital for investors.

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Exclusive CNBC Interview: **"Rising Fear Assets Signal Danger"**

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