



Harry's Take

December 14, 2021

Extreme Concentration of Returns in Nasdaq and S&P 500 Say Top is Near

One of the signs of a major bull market top, and a bubble like this one even more so, is that the buying concentrates more and more in a narrow range of large and well-known stocks. This is called falling “breadth.”

This happens as more everyday investors pile in, especially in the latest stages. Institutional investors like mutual funds look across a wide range of stocks for bargains to beat their competitors. Index funds attract the broadest buying, and they buy in proportion to the index, which also favors the largest market-cap stocks. This is why small-cap stocks almost always peak before the large-cap indices.

The small-cap Russell 2000 peaked on November 8. Bitcoin leads stocks and peaked on November 8. Both have been “warning” a top was likely soon. Now it looks like it may have already slipped in on November 22, the last peak of the Nasdaq and S&P 500.

This chart couldn't say it better. It's the Nasdaq for this year (and I consider this the final year for this bubble). The full index is the blue line, and the yellow/gold line is the index without the top 5 market-cap stocks. And what a difference!

Nasdaq Up 17% YTD, Down 22% Without Top 5 Stocks: Sign of a Top

Without 5 biggest stocks, Nasdaq deeply negative YTD (%)



Source: <https://realmoney.thestreet.com/markets/just-5-stocks-are-the-difference-between-a-bull-market-and-a-bear-market-15854516>

www.HSDent.com

The short story is this: The Nasdaq is up 17% year-to-date as of this chart (it's now up 26%). But without those Google-like 5 super stocks, it would be down 22%. That's a spread of 39%! So, in a late-stage bull market or bubble, it pays big time to buy just the leaders!

The S&P 500 is less extreme but similarly very top-loaded: 51% of its gains have come from the top 5 stocks since April and 33% year-to-date. And that progression shows it is only getting narrower by the month.

I gave my HS Dent subscribers a sell signal for stocks and Bitcoin/crypto on December 8 when Bitcoin broke through a critical level. Now, the failure to make new highs on the large caps as we get clear into the best season for stocks only seconds that call. As of Monday, the Nasdaq's low had gone to 15,417, or 5% below its all-time high on November 22. The S&P 500 is 1.6% from its all-time high.

So, it's not too late to sell—and if we do get one more rally into Christmas, that would be an all-out sell signal. I just hate to hold out for that last few percentage points when I know the first crash will be so steep, by over 50% in 2–3 months.

Here's an alternate strategy: sell half now and the other half by December 22.

Harry

Got a question or comment? You can reach us at info@hsdent.com.