Unbounded Wealth: John's Take 9-12-24

Red Alert…Red Alert

In addition to trend-following strategies, like those I've discussed in the last few weeks, I monitor a series of charts and indicators to help manage risk in my investments.

One of those indicators is currently flashing a bright red alert.

This indicator will **not** predict whether the market will go up or down.

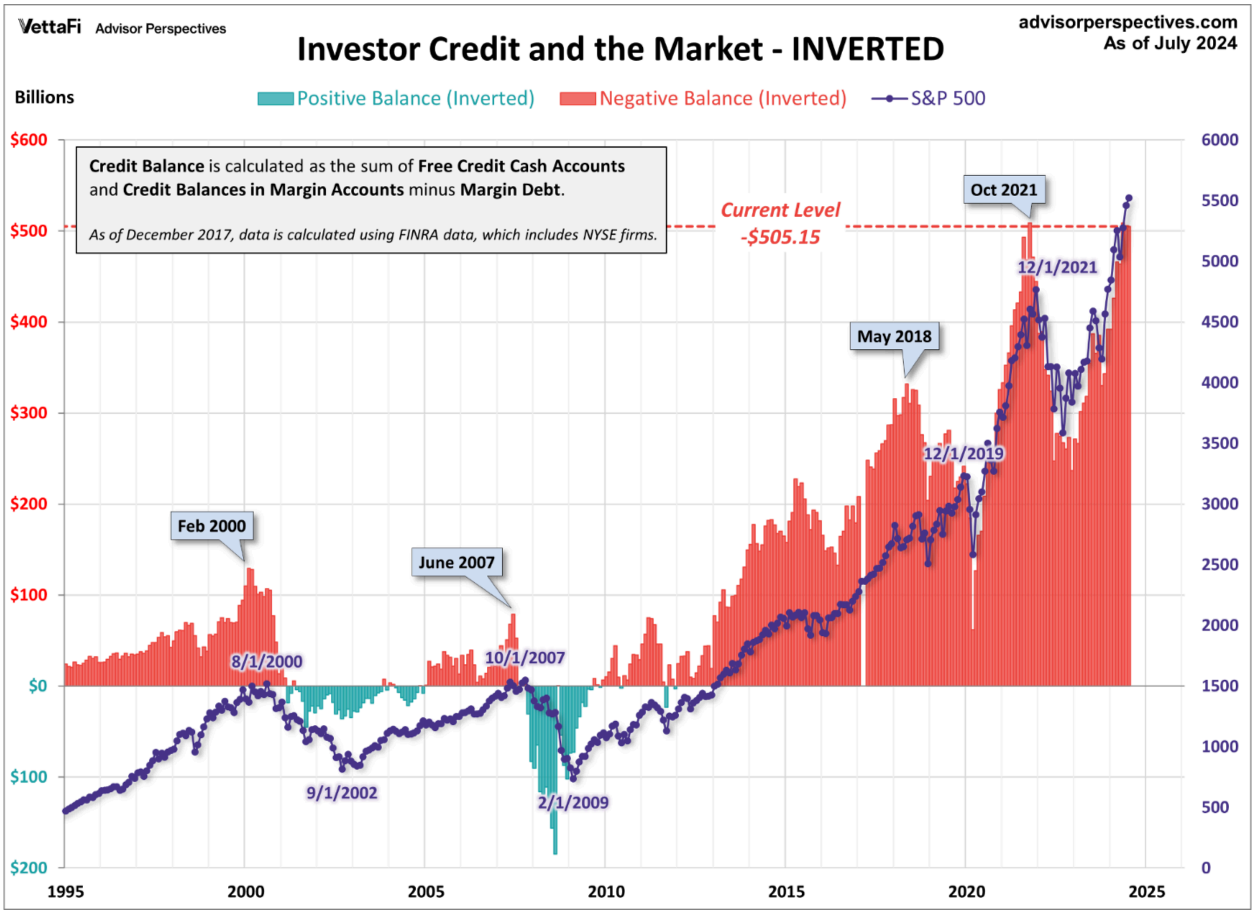
Predictions are a waste of time.

<u>No one</u> knows what's going to happen.

However, in addition to identifying and managing trends, we can easily identify where the markets currently reside on the risk spectrum.

Is it time to pile into stocks with reckless abandon? Or is it time to run for the hills and hide in our bunker? It's not that difficult.

Take a look at the chart below.



The chart illustrates margin debt and is freely available from *Vettafi / Advisor Perspective*. The red areas of the chart show negative credit balances (lots of speculation with leverage). The green areas show positive balances.

Current margin debt levels indicate that we should be concerned about the level of risk in the markets.

Negative balances have been snowballing. Notice the prior high was October 2021, right before the market got its ass kicked over the coming year.

Now, negative balances have hit new highs. Does that mean the market is going to crash? No, it does not.

What it does mean is that the *magnitude* of the next bear market will be amplified by the system's leverage.

Negative credit balances have exploded, and this massive ramping in leverage mostly occurred in a low-rate environment (see 2009). Easy money made it easy to speculate on risk assets.

Rates might level off or decline a bit from here, but they aren't going back to 1% either. If rates do go to 1%, it's because of a massive deflationary bust. A lot of wealth will be destroyed, and speculators will be wiped out.

Either way, when the worm turns it is gonna be ugly.

Here is the most important point of this chart and why I am paying attention to it. ***These are very weak hands in the market***. They have no control over the sale of assets. The margin department is in control of the assets. And, when the market hits a speed bump, these assets are sold recklessly.

Selling with reckless abandon with lots of leverage = crappy prices.

Liquidity dries up. Asset values implode. Weak hands lose *a lot* of money.

This happens every single time. This level of forced selling causes a huge snapback in the market. Imagine stretching a rubber band and then letting go. There's a lot of energy stored in the rubber band as you stretch and stretch and stretch.

With this amount of leverage, the rubber band has been stretched to the max. Once it is let go, the reversal of stock prices will be dramatic—fast and ugly.

As a result, I am concerned about the *magnitude* of the next bear market or significant correction. *There will be* another bear market or significant correction.

The chart above does not provide any clues as to when that might be. However, it's easy to know that the market is currently in the high-risk area of the risk spectrum.

Next week, I will post a chart suggesting that we may be facing an adverse market event sooner rather than later

Stay tuned…

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