



Unbounded Wealth: John's Take 9-26-24

Spread Trades

Last week, I discussed how China's implosion could be the shoe that drops and sinks global markets. U.S. investors are underweight international stocks and often don't pay as close attention to global markets.

The world is interconnected, and the U.S. is as vulnerable to economic calamities from far away as at any time in history, in my opinion.

However, even if China gets hammered, It's not all bad news for stocks.

Long-time readers of my newsletters will know that I favor trades that are deeply out of favor in my taxable account.

These are *long-term* trades. That's the opposite of my tax-deferred retirement accounts, which are trend-following-oriented and may last only briefly.

Consider it a barbell approach with extremes on both sides. On one side, deeply out-of-favor markets. On the other hand, trading whatever is trending the best, with a few proprietary twists, on the assumption the markets will continue to move with the trend.

History shows us that both approaches can be massive winners *if* consistently applied.

These out-of-favor markets are trading out of whack relative to something else and to such a degree that when they bounce back, there's potential for massive and quick gains.

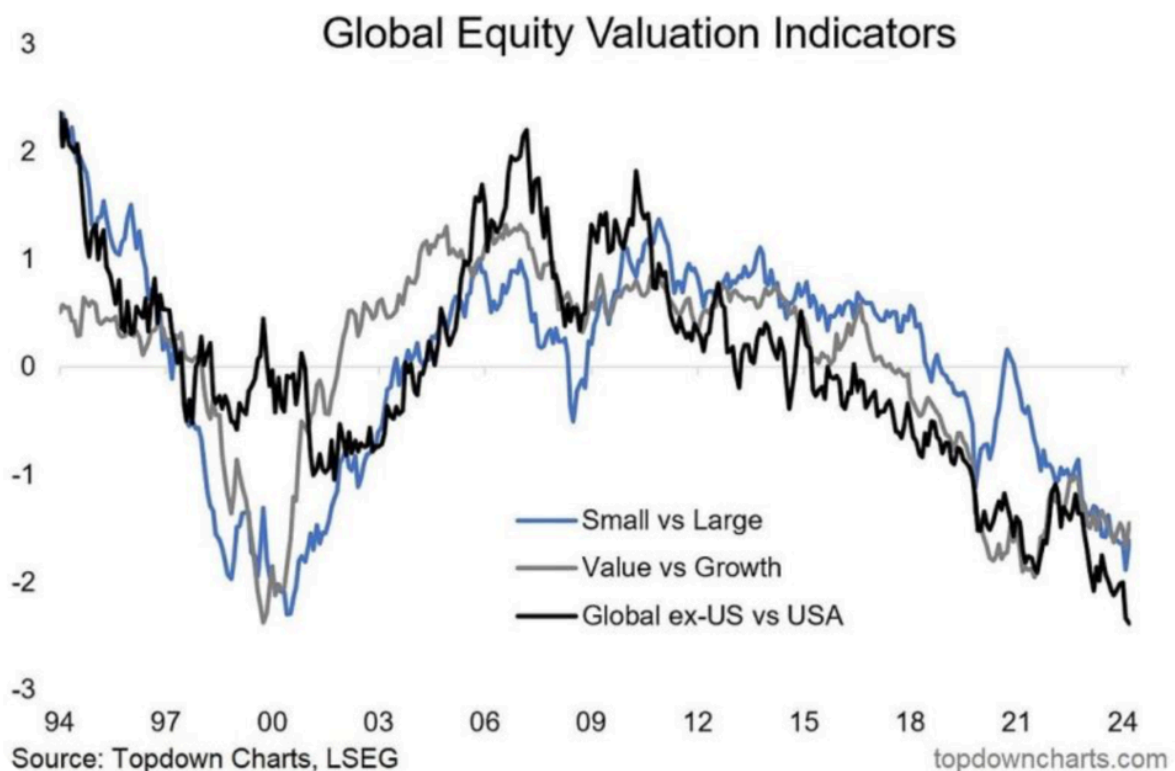
That something else these days is the S&P 500, an index dominated by just a handful of stocks.

For example, the value spread between small-cap and large-cap stocks has become so extreme that it has hit 20-year highs.

As a result, I have gradually bought small caps whenever the market is oversold, and my *Risk-O-Meter* is in the green or neutral zones.

Think of a rubber band stretched as far as it can go in one direction. Once you let go, all that stored energy is released...and...BAM...it snaps back violently in the other direction.

The same goes for financial markets. This week, I wanted to share a chart that captures these spread trade opportunities in three markets and illustrates how out of whack they are.



Small stocks are out of whack relative to large stocks.

Value stocks are out of whack relative to growth stocks.

Non-U.S. stocks are out of whack relative to U.S. stocks.

The chart shows that these markets are near the widest spread this century. There has been a massive reversal since 2009 when large-cap U.S. stocks entered a bull market.

We know that just a handful of stocks are driving the S&P 500. That's not particularly healthy, and the index's market-cap weighting scheme masks the underlying weakness of hundreds of stocks.

When those top stocks get their ass kicked, it's going to be painful. The top stocks always get battered eventually, and the further they are extended from the rest of the market, the more painful the reversal is. Even worse, the leaders of one market cycle are seldom the leaders of the next.

The next bear market, like the last bear market, could reverse these trends on the chart. For one, the spread may simply reverse because the rubber band is stretched so far in the opposite direction that value seekers flood the other markets with capital to take advantage of cheap valuations.

One thing to look for in real time is if the S&P 500 comes under pressure. If these other markets stop going down and head higher while the S&P 500 is still falling, value seekers may have gotten off their couches and started buying aggressively.

Although not recently, I have been building positions in small caps and emerging markets. My position in foreign stocks, excluding emerging markets, has been small. But I am going to start paying more attention from today onward.

What to do next?

I suggest going to etfdb.com and searching the database for the various ETFs that trade these markets.

It's a bit of legwork.

There are more ETF indexes in existence than individual stocks! These days, you can buy an index that tracks anything. To start, I check three things initially.

First, I check the fund sponsor. Larger fund sponsors are more likely to continue to offer an investment product even if it's smaller and not profitable for them.

Second, I check the fees.

Third, I delve into the methodology for managing the portfolio. There are many different ways to define "value." Some are too basic, in my opinion. As a result, they're not different from holding a broader market index.

Yet, they've underperformed the broader market index. Otherwise, they wouldn't be a viable spread trade opportunity.

Remember, past performance is irrelevant here. What's essential is positioning the portfolio to capture the benefits of the spread closing in the *future*.

In my opinion, these trades will work regardless of China or interest rate moves. Those are two big topics in the markets these days. The Federal Reserve has cut rates, so what now? Next week, given interest rate moves, I'll show you an interesting chart that may surprise you.

Until next week...

DISCLAIMER:

THIS COMMUNICATION IS FOR EDUCATIONAL AND INFORMATION PURPOSES AND DOES NOT CONSTITUTE INVESTMENT ADVICE. Any Publishing Service offered by HSD Publishing is for educational and informational purposes only and **should NOT be construed as a securities-related offer of solicitation or be relied upon as personalized investment advice.** HSD Publishing strongly recommends that you consult a licensed or registered professional before making any investment decision.

THE RESULTS PRESENTED ARE NOT TYPICAL OR VERIFIED. HSD Publishing has not verified information regarding the historical trading performance presented. Subscribers' trading results have **NOT been tracked or verified**, past performance is not necessarily indicative of future results, **and the results presented in this communication are NOT TYPICAL.** Actual results will vary widely given various factors, such as experience, skill, risk mitigation practices, market dynamics, and the amount of capital deployed. Investing in securities is speculative and carries a high risk; you may lose some, all, or possibly more than your original investment.

HS DENT IS NOT AN INVESTMENT ADVISOR NOR A REGISTERED BROKER. Neither HSD Publishing nor its owners or employees is registered as a securities broker-dealer, broker, investment advisor (IA), or I.A. representative with the U.S. Securities and Exchange Commission, state securities or regulatory authority, or self-regulatory organization.

WE MAY HOLD THE SECURITIES DISCUSSED. HSD Publishing has not been paid directly or indirectly by the issuer of any security mentioned in the Services. However, HS Dent, its owners, and its employees may purchase, sell, or hold long or short positions in securities of the companies mentioned in this and future communications.

John Del Vecchio is not an employee or partner of HSD Publishing. HSD Publishing serves solely as the marketing arm for John Del Vecchio and Unbounded Wealth: Max Profits.

© 2024 HSD PUBLISHING. ALL RIGHTS RESERVED. 15016 Mountain Creek Trail Frisco, TX 77573.