Is It Correction Time?
Don's Blog 2018.02.05

Do any of you remember the old game we used to play when we were kids, 52 Pickup? Several of my pals and I would be playing a card game when along come a younger brother who began pestering us, wanting to play. After his annoyingness became unbearable we would gladly entice him into the wonderful game of 52 Card Pickup. The end result was the gas house gang throwing the entire deck of 52 cards on the flooring and making him pick it up. Oh, what fun it was for us, not so much for him. Why bring this up? That game was played last week in the stock market when the thundering herd of those that missed out on the greatest stock melt-up couldn't stand it any longer and piled in during January. Please note chart #1.

I waited until this a.m. (Monday) just to see how the stock market opened. I expected some kind of rebound and at this time it appears to be taking place. The question now: is this the beginning of a correction which is way overdue? I don't know. As you well know, I have been looking for one it seems all my life. Please pay attention to the following table which compares various stock market values on the left to subsequent total returns over the next 12 years. This has been compiled by John Hussman and according to his numbers, it will take a 60% decline to eliminate overvaluations.

While this sharp downturn has been going on, the bond markets have also been declining in price (up in yields). Why? Primarily because of the fear of inflation. Why? Remember the floods and forest fires. In my opinion, this is what has caused the mantra of accelerating growth and subsequent inflation. Inflation, or the lack thereof, has the single most causal effect on long-term interest rates. Is this organic growth? No. The spending has increased the GDP but reduced the balance sheet of the economy, therefore a zero-sum gain or even worse, an increase in an already overly burdened debt component of the total economy.

My best guess for the future is as follows: the stock market has probably started a correction phase which could last for a period of time. As some would say "the salad days are over." The bond market after it's correction has abated should rally except the high-yield area. A recession might be in the offing.

P.S. Forget the rebound, maybe tomorrow.

Chart 1

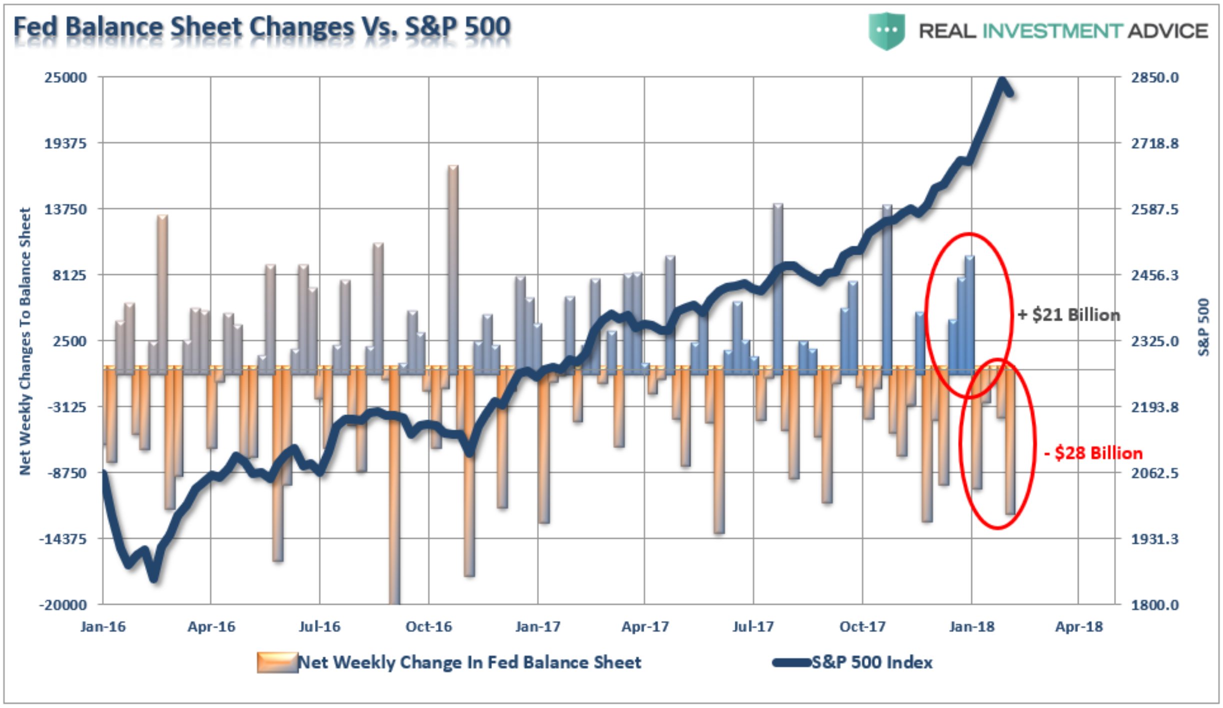

Chart 2

Correlation of log valuation ratios with actual subsequent S&P 500 total returns: 1950-2017		
Metric	10-year	12-year
Nonfinancial market cap/ Corporate gross value-added (Hussman 5/18/15)	-0.91	-0.93
Nonfinancial enterprise value/ Corporate gross value-added	-0.89	-0.91
Nonfinancial market cap/ Nominal GDP	-0.89	-0.90
Price/Revenue	-0.89	-0.90
Margin-adjusted CAPE (Hussman 5/5/14)	-0.89	-0.90
Price/normalized forward earn (Hussman 8/2/10)	-0.88	-0.89
Tobin's Q	-0.86	-0.88
Shiller CAPE	-0.83	-0.86
Price/prior record earnings (Hussman 6/22/98 Barron's)	-0.83	-0.83
Price/Book value	-0.77	-0.79
Price/Forward operating earn (imputed prior to 1980)	-0.78	-0.77
Price/Dividend	-0.77	-0.75
Price/Earnings (trailing 12-mo)	-0.76	-0.75
Enterprise value/Cash flow	-0.70	-0.72
Fed Model (FOE yield-10yr UST)	0.33	0.30
Hussman Strategic Advisors		