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Market Ethos

The latest market insights from Richardson Wealth



Craig Basinger

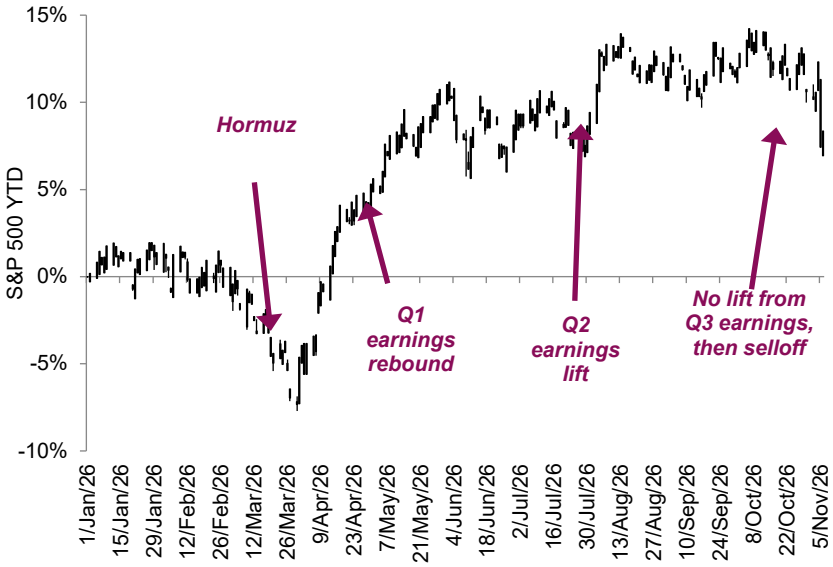
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Drowning out the political noise

Well, that was one wild week. Leading into the U.S. midterm elections, expectations were all over the map. Democrats would make gains for sure, but would Trump contest the results, would he resume attacks on Iran afterwards, and would Republicans pile on policies in a rushed haphazard manner? It appears the size of the blue wave defused all these risks, and markets reacted positively for a day. Then the blue wave turned markets red. Or did it?

Yes, the popular narrative is concern over any potential legislation that slows data centre build outs. With the AI bubble broadly represented in many equity markets and the infrastructure buildout being one of the biggest economic growth drivers, slowing sure doesn't sound good. We are not buying this narrative. Both parties are involved in data centre buildouts in different jurisdictions. And keep in mind, they can be built in many different locations. Yes, the amount of data centre builds in Texas is a bit too concentrated but if they slow, other states (or perhaps even provinces) would start to look appealing.

Blue wave turns markets red



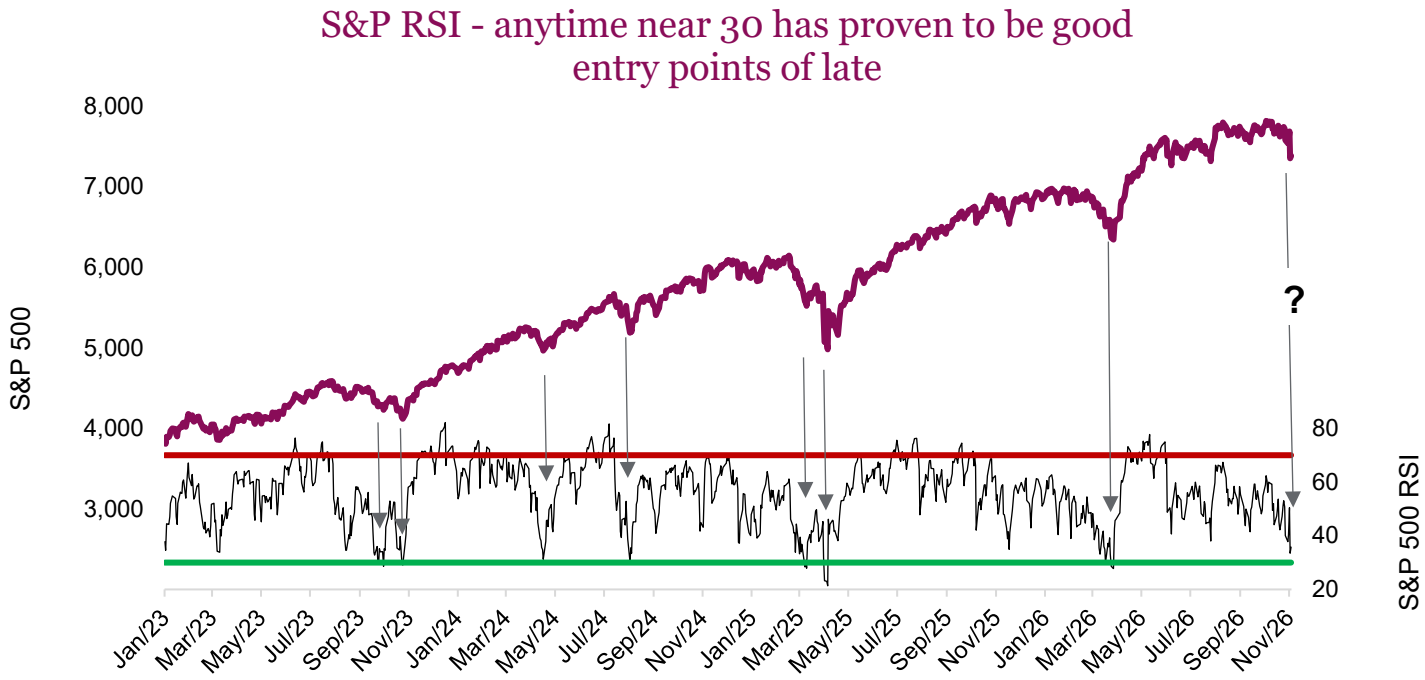
Source: Bloomberg, Purpose Investments

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This market was fragile before the election results. The AI enthusiasm in the market peaked in June and had been struggling since. Q3 earnings season did not help with some major AI companies failing to exceed elevated expectations. The election was just a cup of kerosene thrown on a smoldering fire. This led to a rapid deleveraging trade last Thursday.

It is no secret there is a lot of leverage in this market, whether straight up margin accounts, hedge fund leveraged bets or innovative products that allow investors to more easily apply leverage. A popular trade, and when we say popular we mean crowded, has been long AI and short defensives such as health care or consumer staples. Some of this trade was likely unwinding over the past month, as AI stocks oscillated a bit and defensives flew higher. Well, that unwind went into ludicrous speed last week. Markets also appear to have tripped into CTA sell zones that fed more selling and deleveraging.

When systematic selling floods the market, prices overreact. Thursday pushed the S&P 500 down about 6% from its October 6 high. More interesting is the tech-dominated NASDAQ being off 12% from its high. With the economy in very good shape, this has us in the camp that this is likely a V-shaped correction and not anything more nefarious. The tougher question is whether it's a small v or a BIG V. We don't know the answer to this one, as it will only be known well after the fact. But this kind of exogenous shock, the election results, and systematic selling certainly looks like an opportunity.

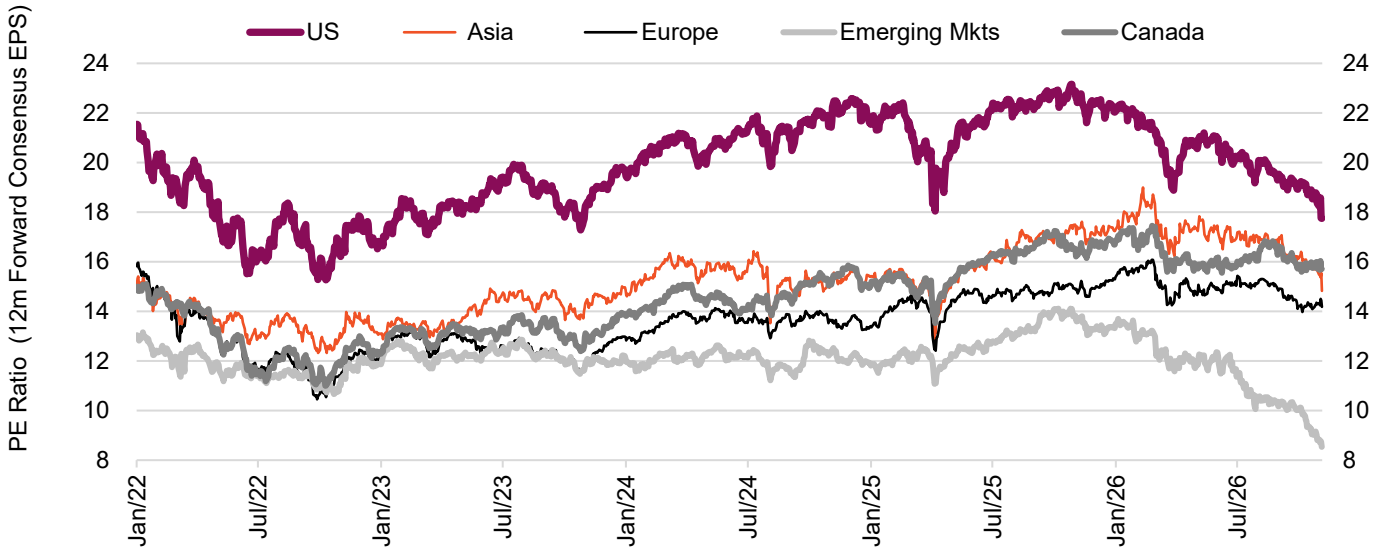


Source: Bloomberg, Purpose Investments

First off, from a technical perspective, things already look oversold. During the past few years, most times when the S&P 500 RSI touched or neared 30, those occasions proved to be good entry points.

We would add valuations have become rather compelling. We typically don't compare one index to another from a valuation perspective mainly because different index compositions often have different valuation dynamics. But emerging market valuations look really cheap, and the S&P 500 at 18 or 19x is also compelling.

Earnings growth plus market pullback has made valuations interesting



Source: Bloomberg, Purpose Investments
US=S&P 500, Asia=Bloomberg APAC Developed, Europe=Bloomberg Europe 600, Canada=S&P/TSX Comp

Final thoughts

Obviously this could become a bigger V, but the pullback, systematic selling pressure and valuations certainly are encouraging. We put more emphasis on the economy and earnings relative to politics as it pertains to markets and portfolio construction. Political shifts do matter, even a bit more so in the era of Trump, but it has been our experience the market more often overreacts to politics. We think that is happening today.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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*This report is authored by Craig Basinger, Chief Market Strategist at Purpose Investments Inc. Effective September 1, 2021, Craig Basinger has transitioned to Purpose Investments Inc.

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