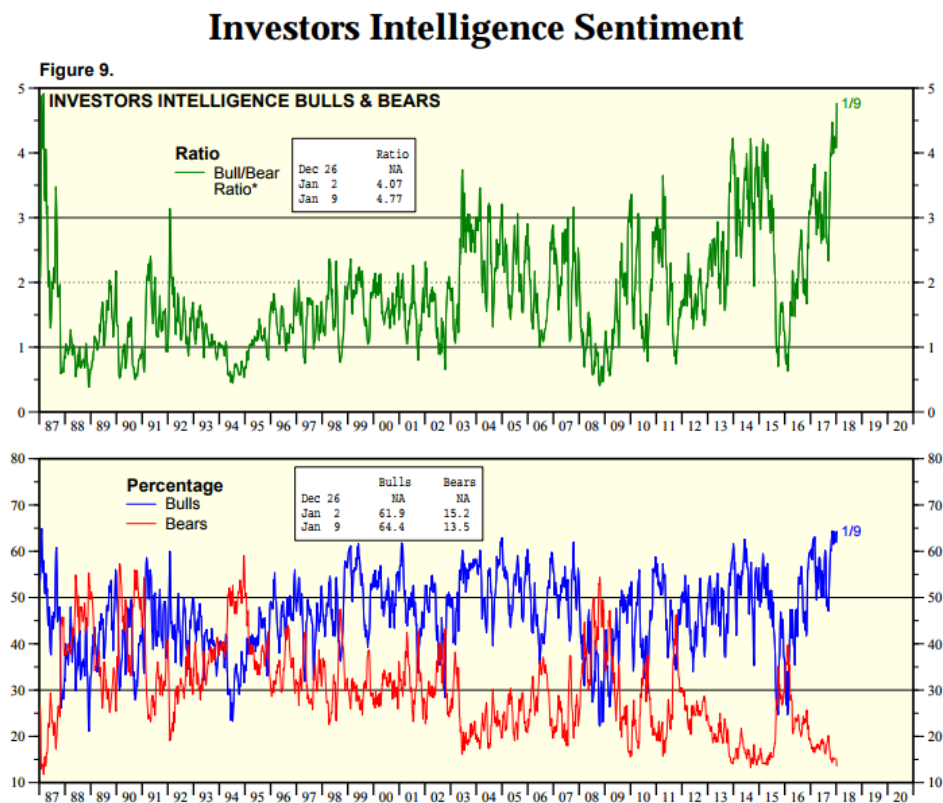


Holland Macro Views

Anthony Bolton's Sentiment Peak?

Last summer we wrote a piece called entitled *'The Pendulum Swings'*. In it we highlighted that sentiment towards equities had moved a long long way from that we observed in pieces like *'Met any Bulls lately'* (2012) and yet even so we assessed it was not (at that time) – extreme. Re-visiting that idea/data today we now see more extreme levels of confidence. We have learnt from the likes of Buffett and Munger that calling market levels is a mug's game. We have also however tried to learn from the likes of Anthony Bolton and others to be more aware of market sentiment cycles, to help us judge the pendulum of fear and greed. Today having looked at a few of our regular sentiment measures again we are inclined towards a little more prudence. As encouragement to engage in this esoteric topic, we also conclude with some of the stocks that we currently hold in high regard against such a backdrop.

Fig.1: Investor Sentiment



Source: Investors Intelligence

Anthony Bolton's book *'Investing against the tide'* we have referenced on this subject before (see August 2017 piece). Despite all his achievements, Bolton seems to still be a humble and thoughtful individual. With that in mind we have always thought the following comment from him in the book was fascinating in its claim of accuracy of market timing peaks. In discussing the idea of trying to identify market peaks/turning points he said there were three signs he looked for and *"when all three factors confirm each other ...the odds are that you are near a*

turning point. You won't spot the right day, week or month, but you should get the right quarter" (our underlining). Were your author reading these last few words when aged say 25, he would probably have just nodded saying – 'yes, I am sure I will be able to do that when the time comes'. At 49 and having been working in equity investing for 32 years via all the peaks and troughs along the way, I will admit to finding such a statement quite a startling claim. Since I first read it c.6y years ago it has made me sit up pay closer attention to the sentiment measures Bolton highlighted especially if they are signalling extremes.

So how does he do it?

We repeat the extract from the book we made last summer, underlining a few sections:

"When evaluating the market outlook there are three things that I particularly focus on – and one that I don't consider. The one thing that I don't look at is the economic outlook, as this invariably looks great at tops and horrible at bottoms. In my experience, economic views won't help you time markets correctly. The three factors that I do look at are: the historical patterns of bull and bear markets, i.e., for how long and how far have we have fallen in a bear market, when the length of time and the quantum of the rise or fall are high relative to history the odds of change of trend increase significantly; I then look at indicators of investor sentiment and behaviour – indicators such as the put/call ratio, advisor sentiment, breadth, volatility, mutual fund cash positions and hedge fund gross and net exposure etc. When these indicate extreme optimism or pessimism.

Source: Investing against the Tide, Anthony Bolton

Economic outlook – Maybe it's great but...

Today's FT carried a good article from Mohamed El-Erian, an economist we have often read and consider both high quality and open minded. We quote from it:

"Both backward-reading and forward-looking indicators confirm that the global economy is experiencing a pick-up in growth that is synchronised, real and multi-dimensional.

For the first time in a while, all of the world's most systemically important engines of global expansion, including China, Europe, Japan and the US, have been shifting into higher gear. Rather than being finance-driven, growth is being increasingly underpinned by fundamental economic forces. Within the process itself, a virtuous cycle between consumption, corporate investment and trade is gaining traction".

Source: FT Tuesday 16 January 2018

What is interesting about this statement is that we agree with nearly every word of it. For some time now, we have believed that a recovery in animal spirits/velocity of money can bring around a more lasting economic recovery than many bearish commentators have believed possible. However as we have observed before there is a difference between an economic cycle and a market cycle. Mr Bolton took that distinction one step further as we outlined above:

"The one thing that I don't look at is the economic outlook, as this invariably looks great at tops and horrible at bottoms"

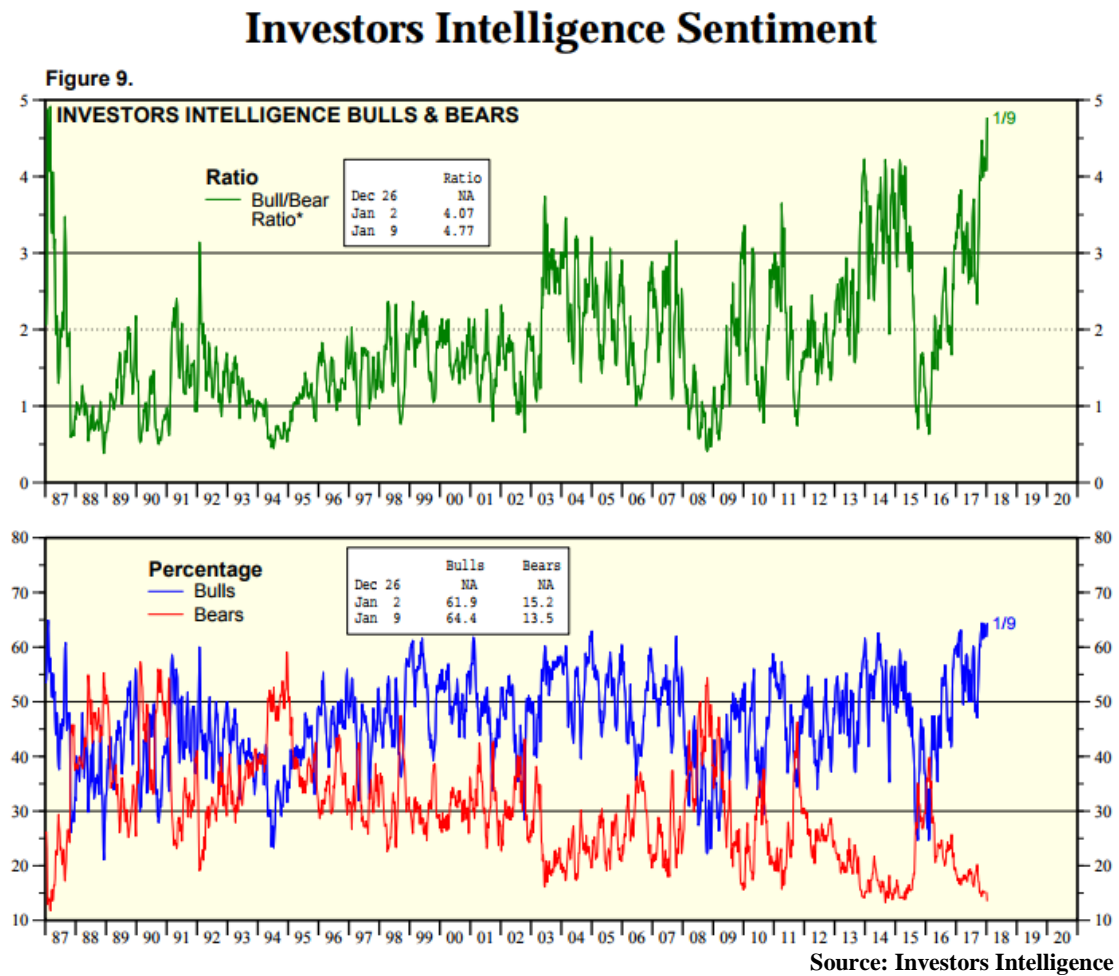
Here we find ourselves fighting our own biases – a hard thing to do as (another eminent investor) Ray Dalio points out in his new book *Principles*:

"I gradually learned that prices reflect people's expectations, so they go up when actual results are better than expected and they go down when they are worse than expected. And most people tend to be biased by their recent experiences" – **Ray Dalio**

Forgive us if we are enjoying being just a little right about the economic recovery underway. Others are maybe fighting a different issue becoming bullish finally as the economic data they have looked for now pushes them in that direction. As a result, let's call ourselves a '*contented holders*' or '*reluctant sellers*' of the securities in our portfolio. Others, we could describe as being 'new buyers'.

The result is surely a supply-demand imbalance that leads to rising prices even from what are high starting levels. (Those that have become more convinced about an economic upswing now want to buy stocks, but we the holders are reluctant to sell them). Mr Bolton's greater focus on sentiment indicators at times such as this helps us to see this dynamic at work. One such indicator we have looked at for many years is the II Sentiment Index which has asked investors whether they are bullish or bearish every week for the last 40 years. The current unusual and extreme level of sentiment resulting (as of Jan 9th) can be seen below:

Fig.2: Investor Sentiment



In the Appendix of this piece we also highlight another sentiment indicator - namely the Put/Call ratio - others will have their own measures such as vix (very low) or institutional/hedge fund cash levels(?). While not all are as clear cut bearish as the excellent and long standing II indicator above they suggest market confidence levels are high or even very high.

The Swing of the Pendulum

Howard Marks has often outlined the human failings of investing by his swing of the pendulum observations. His observations as to the three stages of Bull and Bear markets are we believe timeless:

The Swing of the Pendulum

The three stages of a bull market

- When a few people begin to feel things will get better
- When most people recognise that improvement is underway
- When everyone thinks things will get better forever

The three stages of a bear market

- When a few people realise that things are overpriced and riding for a fall
- When most people see that a decline is taking place
- When people think things will get worse forever

“What the wise man does in the beginning, the fool does in the end.”

Source: Howard Marks – Oaktree Capital Management presentation

Reading these again today it is hard not to conclude we are at Bull market stage 3. None of this is to suggest imminent disaster, but just to make the pragmatic observation of where we are vs. past market cycles.

So; what to do

Let's again piggyback from Mr Bolton learned wisdom:

“Despite having market views, I hardly ever made big market timing views in running my funds.”

“My macro views have tended to set a direction for the portfolio and the type of stocks I am buying and selling. For example, if I believe we are in the mature stage of a bull market I will attempt to prune back my holdings of more risky stocks and those that have done particularly well.”

We conclude to approach equity investing from today's starting point by:

- Paying as much attention to investor sentiment and expectations as to the state of the economy
- To know what we are looking for in franchises and other mispricing's. Remaining highly selective in those we chose to own - only buying when real value is offered
- To fish where others are not

About seven years ago we went west seeking out the franchise quality and value that was on offer in the deep and liquid US stock markets. Today this same market offers very slim pickings indeed. Our enthusiasm for the US banking sector remains, but this is a rare current example of US large cap mispricing of franchise power (yes-we believe the better US banks are franchises). We also however accept that this sector, whilst still having appeal, is less cheap than it was. Outside of this sector we see almost no value on offer in plain sight – i.e. mispriced franchises, but we will keep looking.

The only real value we are finding is perhaps best described as esoteric and thus hard to write about as it comes with many caveats that each investor may take a different view on or have an appetite for.

Our current, some may think esoteric, picks would include:

- Maverick founders – **Sports Direct, RyanAir**
- Long standing hatred – **UK banks, Eurobank, Tesco, UK retailers**
- Cyclical upside from a depressed level – **Teekay** (and some other shipping), **EasyJet**
- Complex conglomerates/turnarounds – **Exor** (not as cheap as it was), **Bollore, CB&I, Melrose, Fairfax**
- Leverage – **Eurobank, Liberty Global, Liberty Media**

Before dismissing these ideas, we would ask readers to take a peak at a piece we published in May 2016. In it we concluded that for all of our attraction to franchises their share prices had run hard. As an alternative we listed 17 stocks that we thought had more value appeal - Our 'Leicester City portfolio' we called it. That list of shares is up by 73% since the piece. Even were we to strip out the Fiat/Melrose treblers the other 15 still rose 43%). In that piece we also suggested a black swan event - "unexpected better growth". We apologise for the blatant trumpet blowing but we wish clients to engage with our current esoteric list and hope this may inspire them to do so.

[The geographic pendulum](#)

The only other area we are finding value is in the UK due to the prevailing mood of doom that surrounds Brexit mania. Whilst sentiment (expressed in share prices) is not as depressed as it was there is still far more value on offer in areas like UK retailing and UK banking than we can find abroad. Of particular interest to us is the **UK Banking sector** as we feel it has a clear precedent to follow the path shown by its US peers. US banks are now priced off of an expectation of less regulation and higher interest rates – in time we think that the same heady formula (absent Mr Corbyn's election) will arrive on our shores. If it does investors will one day reflect on the amazing value that the UK banking sector offered around Christmas 2017. Lastly the odd UK compounder is occasionally offered for sale (Ted Baker at £25, Domino's at 270p) but these bargains do not last for long when global (US) markets have this level of confidence.

We conclude to do as Mr Bolton suggests, observing that sentiment is arguably the driver of markets rather than economics from here. As such we are inclined to be a little more fearful as others greed is becomes more evident. We think it a good time to make the rotation of portfolio Bolton suggests (i.e. from the out-performers to the underperformers) and to look a little harder at balance sheet risks (thank you Carillion for the reminder!).

Mark & Andrew

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[Footnote 1: We love meeting our clients \(face to face!\)](#)

For those of you subscribing for our stock research we make an observation and a request. Ironically, at the very time that new MIFID rules push researchers to be more active in engaging clients (call logging nonsense etc.) there is less to be outspoken about –as obvious mispricing's remain slim! We will stick to our knitting looking out for long term value when it raises its head that should be included in your/our portfolios. When we believe there is a franchise that has wide appeal and is mispriced we will write and/or shout about it, when that is not the case we will look for value elsewhere and leave you in peace. We have researched much esoteric value as outlined above but the best, and perhaps only way to explain this work to clients is face to face. **We politely request such time in front of each of you (when you can spare it).** Please see footnote 2 overleaf

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as advisors to.

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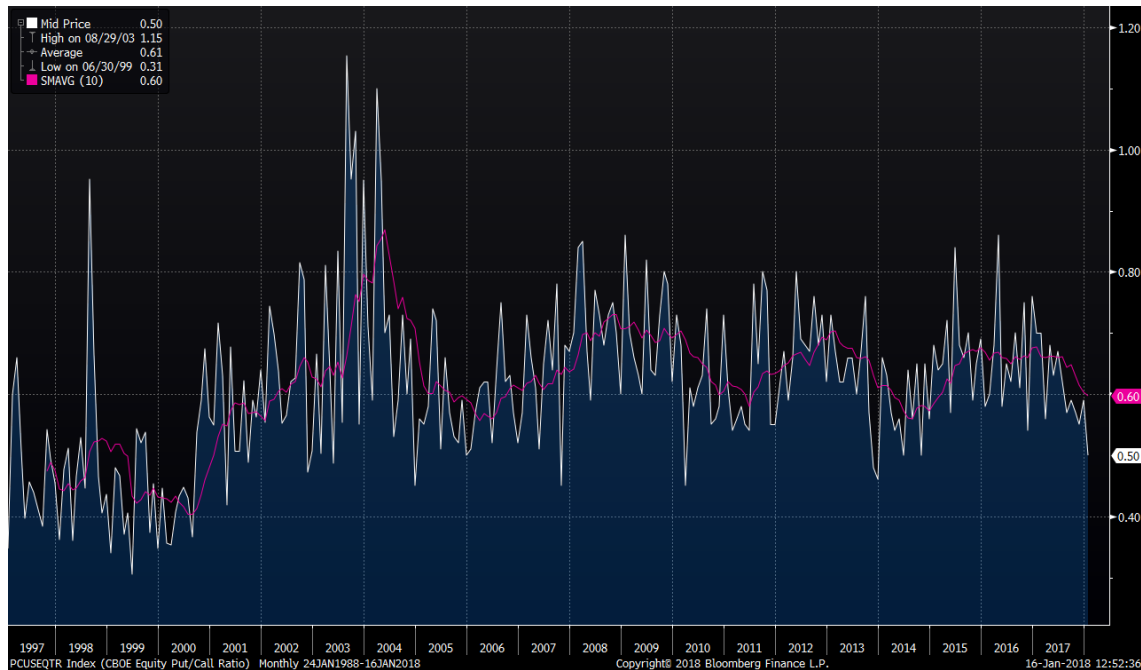
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Footnote 2: A disclaimer to the esteemed Author!

With apologies to Anthony Bolton for the namedropping and plagiarising of his excellent book! In the unlikely event he were to read this piece we would say, “thank you for ‘Investing against the tide’” and we apologise for any misinterpretation/misrepresentation of it made above”. We continue to think it an excellent book for those engaged full time in investment management.

Appendix

Put/Call Ratio – Chart 1



Put/Call Ratio – Chart 2



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