Five years ago, bubbles started inflating in equity markets the world over. The 2015-2016 downturn took some of the air out of all of them and all of the air out of some of them. But since then even the markets that corrected fully have blown new bubbles and the bubbles in those that didn't correct are now enormous. The future for all of them is the next bust in the boom-bust cycle. It now appears that the future is already here—it's just not evenly distributed.

Everyone knows that booms and busts are inescapable features of equity markets. But how do you know it's a bubble before it bursts? And even if you do, how do you know when the transition from boom to bust will take place?

In Part 1 of this What Just Happened?, we review what our Unstable Expansion Indicators have been warning about bubbles for the past 5 years[2]. In Part 2 we present our answer to the question of timing.

Unstable Expansions Signal the Presence and Extent of Overheating

Omega Analysis' risk measurement technology reveals predictable Risk Cycles that are leading indicators of asset price booms and busts. Unstable Expansion–unsustainable asset price increases–signal overheating and predict the correction levels that will result.

Equity markets the world over went into Unstable Expansion shortly after the market recovery began in 2009. The sharp downturn following the US credit downgrade in August 2011 deflated the nascent bubbles and markets fell through our predicted correction levels.

But by Q4 of 2013 new Unstable Expansions were present in equity markets everywhere and nowhere were they signalling more pain to come than in the U.S. By early 2014 our indicator was predicting that the S&P 500 Index would eventually fall by 33% and the Nasdaq 100 Index by 49%. (For reference, the S&P 500 Index finished January 2014 at 1,860, the Nasdaq 100 Index at 3,696.[2])

Current Predictions

When the next market scare came in 2015-2016, emerging markets and some developed equity markets (such as the FTSE 100 and the S&P/TSX Composite) fell to our predicted correction levels[2].

But U.S. markets almost immediately shook off the setback. By February 2016, after falling some 12%, the S&P 500 Index began another rapid climb. By last week, our measures indicate a correction of more than 50% is now to be expected. For the Nasdaq 100 Index that rises to almost 70%.

In the same period global equity markets also experienced yet another boom, further inflating their bubbles. Our current predicted corrections in world equity indices range from 30% to 40%. For developed market equities *excluding* the U.S., the correction has been underway for months with less than 15% still expected.

Figure 1 shows how unevenly distributed this phase of the worldwide equity boom has been. The expected correction in DGT, an ETF tracking the Dow Global Equity Index, is almost 40%. In SPDW, an ETF tracking the MSCI World ex U.S. Index, the predicted correction has largely already occurred with less than 13% still to come[3].

(Continued...)

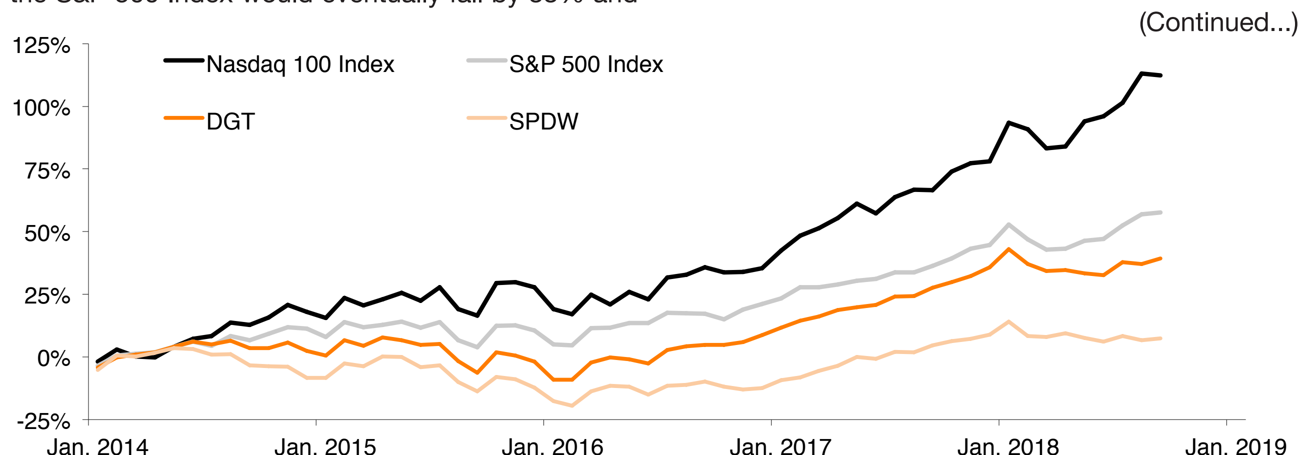

Figure 1. S&P 500 Index, Nasdaq 100 Index, DGT and SPDW in % from Jan 2014 to present. Only U.S. equities have regained their January 2018 peaks.

[1] William Gibson NPR Interview, 1999. https://quoteinvestigator.com/2012/01/24/future-has-arrived/
[2] http://www.fields.utoronto.ca/video-archive//event/414/2015
[3] For current Correction Level predictions in specific equity markets Risk@OmegaAnalysis.com

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The Next Global Equity Market Downturn may already have begun.

Emerging market equities have dropped by nearly 20% since their peak in January of this year with China pushing them lower almost every day. The DAX is down 12% in the same period. And global developed market equity indices and ETFs tracking them have dropped by a similar amount after trending upward steadily in Q2 and Q3.

By contrast, the S&P 500 Index recovered and exceeded its January high before the latest bout of Fed 'craziness'. But the S&P 500 Index has been distorted by the presence of 5 massively valued tech stocks. By mid 2018, the FAANGs represented over 14% of the market capitalisation of the Index. Without them, the S&P 500 Index would not have regained its January level. Figure 2 shows the S&P 500 Index with and excluding the FAANG stocks for 2018.

Just as the FAANGs have been responsible for the latest U.S. equity rebound, U.S. equities have dragged up global equity indices. Without the U.S., global equity markets have been trending downward for the past two quarters. Absent 5 extraordinary U.S. tech stocks, it appears that the downturn in global equities may already be underway—it's just not evenly distributed.

END of Part I

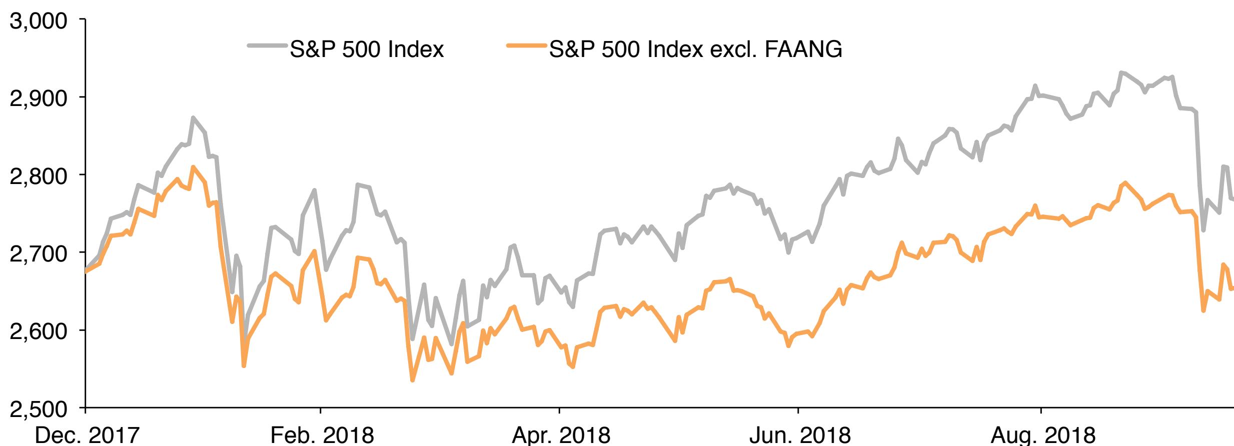

Figure 2. S&P 500 Index and S&P 500 Index excl. FAANG from 31 Dec. 2017. Without the boost from the FAANG stocks the S&P 500 Index would not have regained its January 2018 peak. The predicted correction in the S&P 500 is over 50%.

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