Omega Analysis Notes

Accidents Waiting to Happen.

A new series for the final phase of the 'Everything Bubble'.

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Ten years of unprecedented monetary intervention by the world's central banks has produced an 'Everything Bubble' in which assets of all sorts, in markets all over the world, have inflated—many to a truly alarming extent. Some are already deflating, producing anti-bubbles of panic selling. Our new series 'Accidents Waiting to Happen' will document these events as we move into the final phase of the 'Everything Bubble'.

'Statistical Macro' Indicators.

The Omega Metrics® suite of 'statistical macro' indicators was originally designed for a major commercial bank's investment market intelligence and to inform a G7 Central Bank's policy decisions.

Market Modes provide early warning of asset price bubbles and anti-bubbles with highly predictive estimates of eventual Correction Levels in each case. Market Risk Analysis gives accurate measures of downside exposures at daily, weekly, bi-weekly and monthly time horizons.

These indicators apply across asset classes and at levels of granularity from regional to country specific to sub-sectors and individual assets.

They are coupled with Multi-Trend Analysis which provides accurate assessment of the current phase in market cycles.

It's never 'too early' to recognise a bubble (or an anti-bubble).

We began observing equity market bubbles shortly after the U.S. equity market recovery started in 2009. There's a common misapprehension that observing an asset price bubble is a signal to sell and that being 'right too early' is the same as being wrong.

But that's precisely the opposite of what a 'buy low, sell high' approach tells you. It's perfectly rational to buy a bubble, in the expectation that the price will continue to rise. The critical caveat is that you need to understand the risk in this position and to have a strategy for dealing with it.

Likewise, the rational response to an anti-bubble is to sell. The fate of Lehman Brothers and the Royal Bank of Scotland in the 2008 financial crisis provided perfect illustrations of what happens to investors who get this wrong.

The Trend Matters.

Not only is it rational to buy a bubble, but it's irrational to sell one—*unless the market trend has turned from up to down*. The ability to observe this transition is critically important for investors, especially in dealing with bubbles that have inflated to extreme levels.

For the past century, the turning points in the U.S. equity market cycle have led global economic trends. It has never been 'different this time'.

Market Risk Matters.

There is a detectable risk cycle in financial markets. Drawdown risk at multiple time horizons always increases as booms turn to busts. After a boom has been present long enough, complacency and failure to appreciate the likelihood and severity of loss are a very dangerous combination.

Omega Metrics® risk measurement technology provides accurate and timely warnings of the probability of severe drawdowns (among a plethora of examples, our August 2017 prediction that a wipeout of the Short VIX trade was imminent).

Accidents Waiting to Happen Now.

The bubbles we observed emerging in 2009 corrected to the levels we predicted in the aftermath of the 2011 U.S. credit downgrade.

But by 2013 the overheating had resumed world wide. Some of the bubbles that emerged then corrected fully in the 2015-16 downturn; others are still expanding—including in major U.S. indices, sectors and individual companies—and have reached frightening proportions.

We are now in a regime were some bubbles have already corrected violently with asset prices going into anti-bubbles of panic selling. Others deflated more sedately and still others have yet to pop.

The extent of the coming corrections and the timing of the bubble deflation vary greatly across regions, countries and asset class sectors.

Turning point indicators and very high levels of market risk indicate that the end game of the everything bubble is now presenting investors and policy makers with a panoply of accidents waiting to happen.

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