BILLS ASSET MANAGEMENT

BAM MARKET NOTE

AUGUST 9, 2024

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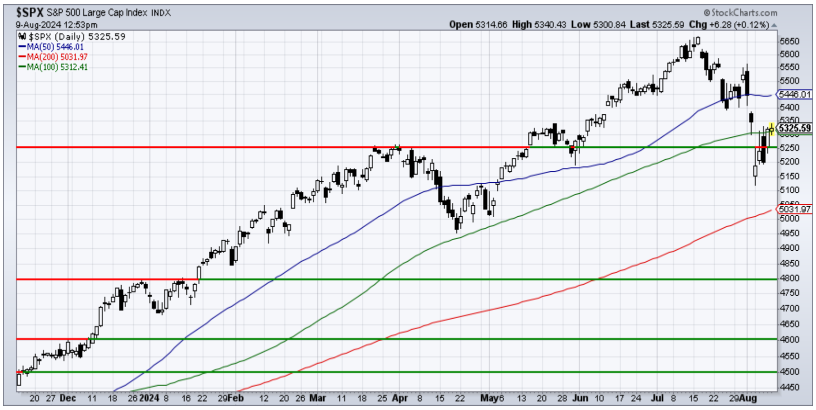
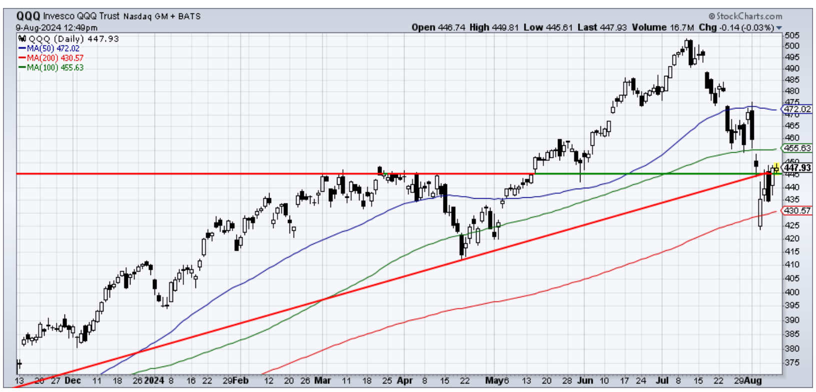


What a crazy week! Monday saw a huge drop as sellers hit the exit on bad news out of Japan (more on that below). The VIX (a measure of fear in the market hit 65 – just the 3rd time it has hit this level (2008 financial crisis and 2020 during Covid). It was a spectacular and scary start to the week. However, it looks like cooler heads have prevailed. The VIX has returned to the lower-20's (elevated a bit but not panicky) and the markets have stabilized. In fact, the S&P has recovered nearly all of the early week losses and looks to finish the week mostly flat. Prudency demands continued caution, but a bottom may have been set.



We showed this chart last week and noted that the bulls needed to hold the levels of last Friday to avoid more carnage. While the bulls failed spectacularly on Monday, they have come roaring back, and we are right back to where we were last Friday. The Nasdaq 100 quickly recovered the sell-off and is back to the convergence of support-resistance and the uptrend line from last year's October bottom. This remains a key level and one that will need to be held to avoid a return to the lows of Monday – around the 200-day moving average and some 4% from current levels.

Our Point

While some blamed the weak jobs report on Friday and recession fears for the sell-off, the big culprit was Japan. For years, Japan has been functioning with interest rates at 0%. In simple terms, hedge funds and other large institutions have taken advantage of the low rates in Japan by borrowing money in Yen, converting it to dollars and investing in the US markets. Borrowing free money and then making outsized returns in the US markets has been a winning strategy over the last several years. Additionally, many of these investors have further leveraged their bets to get even greater returns (and increased risk!). The Yen carry trade, as it has been called, has been a viable strategy for those with access to the Japanese markets. That changed at the end of July as the Bank of Japan (counterpart to the Fed), unexpectedly raised rates. The unexpected rate increase roiled the Japanese markets culminating with a 12% loss on Monday and caused a surge in the Yen. The result was a global sell off and fears that the Yen carry trade was being unwound – it may yet still. It was certainly a shot across the bow for markets around the world and the market fear was only surpassed by the 2008 financial crisis and the outbreak of Covid. Since Monday, the Bank of Japan has assured investors that additional rate hikes are not anticipated. Japanese markets roared back and the fear has subsided. Damage has been done, however – technically and psychologically. One comfort, amidst all the chaos, has been the performance of high yield bonds. As noted here often, high yield performance is often a harbinger of things to come for the US economy. While high yields sold off with the market, they have recovered all of their losses and are nearing their all-time highs. The bond markets are not predicting a recession any time soon. At this point, it appears that we have witnessed a scary and violent sell off that looks to be nothing more than a normal (albeit scary) correction. We'll know more over the next week or two. Volatility is sure to continue as some of the damage done is absorbed and a revisit to the lows is not out of the question. That said, we are likely closer to the lows than the highs. We made a small change to our portfolios as we sold a position in our aggressive portfolio that met our stops and replaced it with a new equity position near the lows. We have a little bit of cash in our conservative and moderate portfolios that we may put to use if the recovery holds. Tomorrow's preseason Titan's game marks the start of the 2024-2025 campaign. There is always optimism this time of year but with a new coach and an exciting offense; optimism reigns. This time of year, every team is a Super Bowl contender! Thanks for your trust in this chaotic market. Titan up and have a great weekend.