

"Buy The Dip" Mentality Fully Entrenched

Posted: 22 Sep 2009 10:20 AM PDT

Anyone following the markets knows there is a huge underlying bid.

Among individual investors as well as fund managers "Buy the Dip" Mentality Prevails. Claymore's Schwager believes the high levels of cash on the sidelines coupled with increased risk-taking will result in buy-the-dip behavior and provide a downside buffer. The "buy the dip" mentality was evident last week after investors surfaced following sharp losses on the prior Friday (8/14) and then again last Monday. As mentioned in recent weeks, there were large levels of cash on the sidelines.

According to the Investment Company Institute (ICI) there was \$3.6 trillion sitting in money market mutual funds during the week ended August 19. While cash levels are down from the \$3.9 trillion reached in mid-January, the current level remains 1.5 times higher than the 10-year average.

This, coupled with anecdotal evidence that large institutional investors remain underweight in equities, seems to be fostering a fear-of-missing-the-rally mentality. From a portfolio manager's perspective, the second worst thing to actually losing money is underperforming your benchmark. Being underweight stocks and overweight cash would generally hold back performance in an environment of rapidly rising stock prices.

Sideline Cash Myth

Anyone advising clients to "buy the dip" based on sideline cash shows a fundamental lack of knowledge about how markets work.

For every buyer of securities there is a seller except at IPO time, secondary offerings, ect. Thus, it is virtually impossible for money to come into the market in normal day-to-day trading transactions.

For example: If one firm invests \$100,000 in equities, then another firm will be selling \$100,000 in securities. The end result of the transaction is "sideline cash" moves from firm A to firm B.

Furthermore, because of monetary printing, one should expect the amount of "sideline cash" to rise over time. Sideline cash is higher than it was 10 years ago and will be higher 10 years from now barring a huge number of IPOs or secondary offerings that would suck up some of that sideline cash or a period of heavy monetary draining by the Fed.

Why Is The Market Going Up?

The market is going up because sentiment has changed. Buyers have become more aggressive, in relation to sellers. Sellers want more for their shares. There is a near panic "have to get in" attitude among retail investors.

Finally, rather than looking at sideline cash numbers in aggregate, one should look at Mutual Fund (MuFu) cash levels instead.

Please consider [Rally in 6th Inning or Top of the 12th?](#)

The opinion that the market can and will continue to rise is becoming ever more widespread, and ironically the bulls ALL say the same thing, namely "everybody else is bearish".

Mutual fund (MuFu) managers are not bearish, that much is certain. At 4.2%, the the MuFu cash-to-assets ratio is one of the lowest in history, in fact lower than at the 2000 top, and only a hair above the 2007 low. Those stats (from a friend) are from July. Given the continued rally, MuFu cash on hand has probably decreased even more in August.

The Dow's dividend yield is now at the level of the the 1968 top and the September 1929 top. Good luck with that!

Unlike sideline cash numbers in aggregate, MuFu cash levels might be considered a measure of sentiment, and if anything, those cash levels would suggest most fund managers are already "all in".

Investors Optimistic

Today the Financial Times is reporting [Investors optimistic on rally](#). Investors became increasingly willing in the third quarter to bet that the current rally driven by rising appetite for risky assets has further to go.

Research by Barclays Capital, drawing on opinions from hedge funds, asset managers and traders from institutions across Europe, Asia and the US, showed that more than half of the 820 respondents felt the rally seen in the third quarter was sustainable.

This was in marked contrast to the wealth manager's last investor sentiment survey published in June – when the majority of investors interviewed believed the then-powerful rally from March lows was a short-term correction.

Now, only 19 per cent believe they are still witnessing a bear market rally and are expecting a significant downward correction in the coming months.

"Recent data have surprised to the upside and more and more bears who were previously sitting on the sidelines have capitulated and are joining in."

Insiders Sell Hand Over Fist

Meanwhile, as retail investors and fund managers chase a rally running on extreme sentiment, [Corporate insiders continue to increase the pace of their selling](#). The bravest face you can put on corporate-insider behavior right now is to point out that they're often early -- anticipating market moves by as much as 12 months in advance.

But otherwise the message from the insiders is rather sobering: They are selling a whole lot more of their companies' stock than they are buying. The net difference is even larger than it was two months ago, when I noted that insiders were already selling at a greater pace than at any time since the top of the bull market in the fall of 2007. [See [Insiders Are Selling](#) - July 28, 2009]

Consider the latest data from the Vickers Weekly Insider Report, published by Argus Research. For the week ended last Friday, according to Vickers, insiders sold 6.31 shares for every one than they bought. The comparable ratio two months ago was 4.16-to-1, and at the March lows the ratio was 0.34-to-1.

As Vickers editor David Coleman puts it in the latest issue of his newsletter: "Given the dramatic decline in our sell/buy ratios over a relatively short period of time and the robust rally we have seen in the broad market averages, we expect the overall markets to trade flat to downward in the intermediate term -- and with increasing volatility. Overall insider sentiment is bearish by nearly all metrics we track."

As Hulbert mentioned, insiders are not always right. Moreover one should not use insiders buys and sells as a timing device but rather a gauge of sentiment, and that sentiment is as extreme as it gets.

Thus, suggestions to "Buy the Dip" based on sideline cash not only shows a lack of understanding about how markets work, they also show a lack of understanding about how extreme sentiment is among retail investors and fund managers, even as insiders (who likely know much more about business fundamentals) are selling hand over fist.

Risk is not high, it is extreme.

Mike "Mish" Shedlock

<http://globeconomicanalysis.blogspot.com>