

## Under the Covers

As we witness the market go up up and away, we are paying a lot of attention to what is happening under the covers of the stock market. The indices are high and going higher, but the number of stocks participating in the rally are diminishing rapidly. We're seeing more stocks hit all time lows than all time highs on almost a daily basis. We're seeing the volume of trades higher on down days than on up days, meaning the sellers are selling more than the buyers are buying, yet indices go up. People ask how this is possible and it's because indices are cap weighted, which means the largest cap weighted stocks have a much larger impact on the index than the smaller cap weighted stocks. Since this rise is being driven by fewer and fewer stocks over time, the institutions can sell their shares to the individuals almost on a stealth basis.

This isn't something Wall Street would ever publish, but is something everyone who has any money in markets or funds should now and know well. The chart below from our friend Dana Lyons shows just how extreme this is. Note the all time low relative difference between the overall Nasdaq and equal weighted Nasdaq. This shows in a graphic what I've been writing.

### Equal Weight Nasdaq 100 Drops To All-Time Relative Low



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## Banking Shrinking

The world of banking is shrinking in terms of the number of branches available to consumers to walk into and transact business. There is always online, and some banks are online only now and that is what some consumers prefer. Interestingly the large banks are consolidating and closing branches and the small local banks are opening branches to capture market share. The regulatory element is a big deal for banks, the large banks have the resources to deal with the government red tape but the small ones really feel the pinch in costs from a compliance perspective. Many smaller banks slow down or stop growing to avoid the next level of regulatory costs and complexity. This is why you may be feeling a bit of a longer drive in finding your nearest bank branch. The chart below shows the trend of total number of banks to serve the public in various geographies and total assets of banks. The bottom line is that the banks are bigger in terms of assets but smaller in terms of the number of branches to serve the public.

Figure 3.2. Changes in the Number of Banks and the Size of the Banking Sector



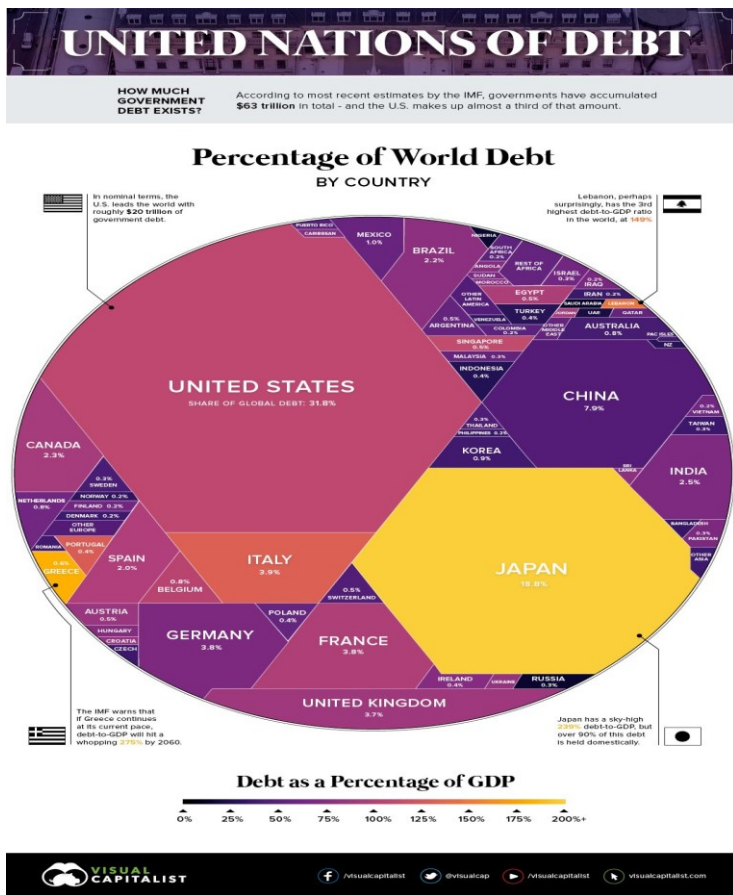
Sources: Bank of England; Bank of Japan; Bank of Russia; CEIC database; Deposit Insurance Corporation of Japan (DICJ); European Central Bank; Reserve Bank of India; U.S. Federal Deposit Insurance Corporation (FDIC); and IMF staff estimates.  
Note: Number of banks refers to the following: for the United States, number of FDIC-insured commercial banks and savings institutions; for the euro area, the United Kingdom, and Russia, number of credit institutions; for Japan, number of DICJ-insured banks; and for India, number of commercial banks. The jump in the number of credit institutions in the euro area in 2008 corresponds to a change in the population of included banks in one member country.

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## Under the Covers (cont'd from page 1)

Now as we transition from the behavior of the majority of the stocks within the stock market we take a quick peek at the debts of the world. The debt levels are going up at record paces all across the world as global governments and central banks continue to try and print their way out of a debt problem. Folks think about this, we had a debt problem in 2009 and then the Big Recession, and since we've been printing money (making more debt) in an effort to fix our debt problem. This sounds a lot like the definition of insanity that says you cannot expect different results if you keep doing the same things. I'd agree 100%

Below is a great infographic on the global debt breakdown per country as a percentage of world debt. We're big spenders here in America, and we love debt. I truly wish we'd lead the world by example on how fiscal stewardship should work, but instead we do the opposite. We're not alone and we're more capable of paying back our debts. Japan, China, most of Southern Europe is essentially mathematically impossible to get out of their debt situation. Thanks to the visual capitalist for the chart! ☺



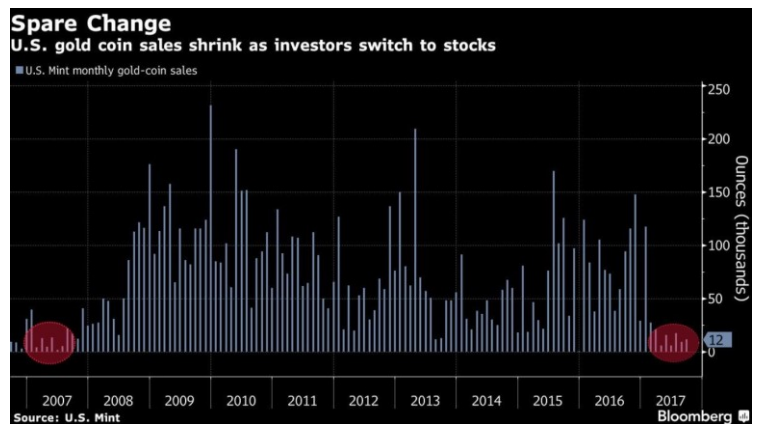
**Open Position @ CFA**

If you know anyone who is looking for a front office position please think about connecting us. The person we're looking for is someone who has great people skills, highly organized and detail oriented. They must be proficient with computers, Microsoft Office & CRM. We know there are plenty of great people locally who are looking for a job and it's just a matter of making the fit.

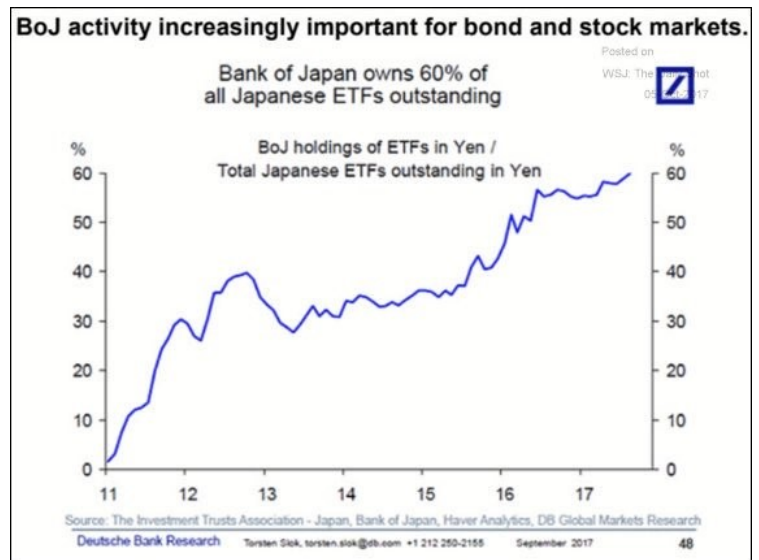
## Watching the Flows

The crowd is chasing hot stocks and have been now for many years. With valuations being what they are today, this is a very dangerous game. We're sitting back and watching this madness, frustrated that we didn't go all in when things were only 75% overvalued now looking them at 100% overvalued on average. Our discipline is that of value and momentum bubble chasing isn't value investing, it's like putting all of your money on 38 Black on the Roulette wheel.

We do like a lot what nobody is paying any attention to, the metals in particular. We've got a deep value situation here where metals are being ignored today, as the money is chasing the hot stuff. Once the rotation out of the hot stuff gains more steam, the money will go to the beaten down sectors, which are the metals, commodities and a few select equity sectors, energy and retail in particular.



I cannot say anything is sane today from a government action level, but what is truly insane is just how much the Bank of Japan (the Japanese Equivalent of our Fed) has been buying ETFs in the Japanese stock market. The chart below shows us that the BOJ now owns 60% of all Japanese ETF's. Houston, we have a problem!



## Noteworthy News!!!

- Congratulations to Christine Bascetta on her job with United Bank! ☺
- Congratulations to Cynthia Masters on her recent retirement! ☺
- Congratulations to Mark Danaher on his new job with the Fairfield School District! ☺
- Congratulations to Roger Sylvester on his recent retirement! ☺
- Congratulations to Nadine Zoni on her recent retirement! ☺
- Congratulations to the Fador family on the birth of baby Trey! ☺

## Question & Answer

Ask any financial question you have and we'll address it here.

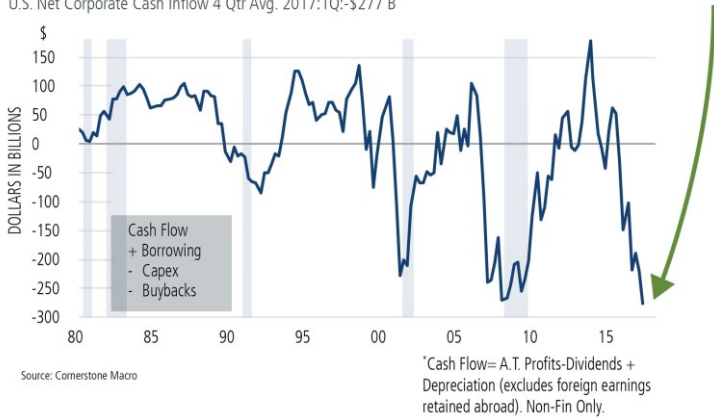
*Q: What is the cash flow situation with corporate America today?*

That's a priceless question! The amazing fact is that corporate America is on a spending binge, buying more than it can afford overall. Many businesses are struggling and some are really thriving, but the companies are spending a lot of money on capital expenditures and stock buybacks. I love the concept of companies buying back stock, but not at high prices and they tend to do it almost always at the wrong times. The chart below illustrates just how the data looks when you factor in the borrowing, capex and buybacks. We're at a point that looks very much like 2009 ish or soemwhere in that era.

### CORPORATE AMERICA SPENDING MORE THAN IT'S TAKING IN

From 1Q 2016 to 1Q 2017, corporations took in \$1.9 trillion (cash flow plus net new borrowing) and spent a combined \$2.2 trillion on capex and buybacks. The net cash outflow of nearly \$300 billion is the largest "deficit" on record.

U.S. Net Corporate Cash Inflow 4 Qtr Avg. 2017:1Q: -\$277 B



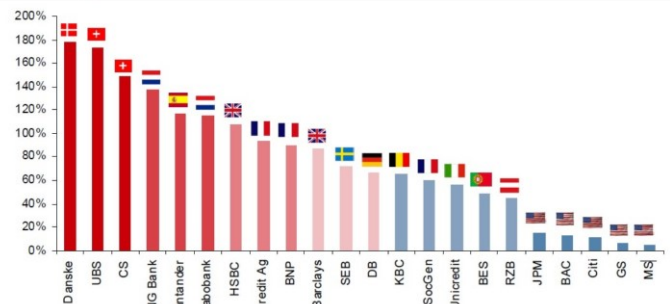
Thanks to our friends at Cornerstone Macro for the chart. The bigger picture here is to seek out companies that are living below their means. Even though companies are buying back stock, corporate executives are selling it. The Oct 26th SEC report on form 4 insider buying and selling shows a total buying of maybe 1.5Million with total sales of 25 Million from corporate executives. Telling, quite telling the people running the companies are selling stock at 15 times the level they're buying it.

Now as banks get larger by asset size and there are fewer of them, we need to consider how this impacts the economy overall. The fewer banks we have that are bigger, the larger the risks of those banks are on the system if they face another crisis. Europe is particularly in trouble here as they are so indebted that the banks there are bigger than the government can deal with if anything goes badly. The chart below shows us the largest banks around the globe and note in Europe and the assets of each bank as a % of the Country's GDP. These are outrageously large numbers, something we don't even come close to here in America. The five to the right of the chart are the biggest American banks, note their assets as a percentage of GDP are tiny in comparison to their foreign counterparts.

### Too big to fail has not gone away

European banks – not only in the periphery – are too large for governments to bail out

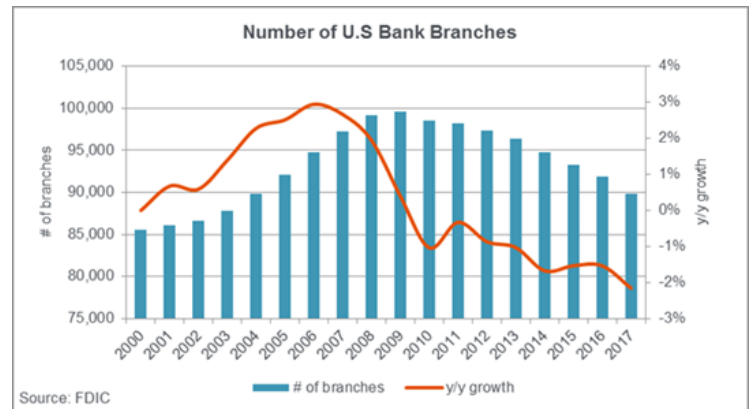
Who is too big to fail?  
Bank assets / GDP, by individual institution



Source: RBS Credit Strategy, Bloomberg, company filings

I'd be very cautious about owning any of the monster banks that outsize the GDP of their country of domicile.

Now looking local at the bank branch situation, we see a very clear indication of what is going on with branches in America. What we've seen locally in the past 10 years is the monster banks just close a plethora of branches and the small local banks building new ones very slowly in a safe and steady manner, all within a low risk and low leverage environment. We're also seeing many bank acquisitions, and with each one it normally comes with a number of branch closures.



Source: FDIC

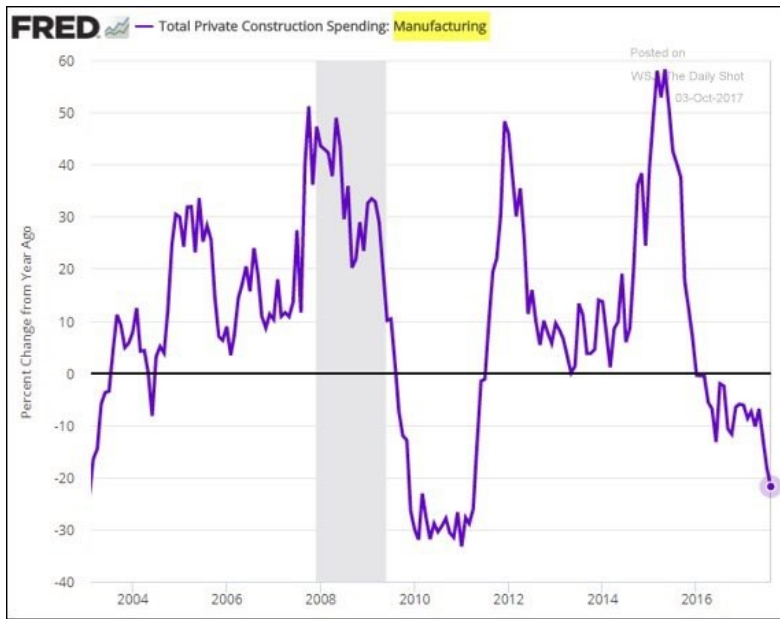
# Money Quiz



This month's challenge is on the housing market, and its values are high again but we want to take a peek at what renters are thinking. What percentage of renters believe right now is a good time to buy a home? Last month's quiz was won by Cecily Monaco, the QE program launched in 2009 took 8 years to begin reducing after the Fed starting talking about doing so. Talk about moving slowly? Winner goes to Ruby Tuesday on us! 10/30/17: 6

# Education & Employment

The economy is very odd today, it's okay in general, great if you're somehow tapping the government gravy train of printing money and mostly otherwise lukewarm. The chart below from our Friends at the St. Louis Fed show us that the amount of private construction spending going on in private industries on their manufacturing facilities is declining precipitously. Interesting metric to know about as we see the drama unfold.

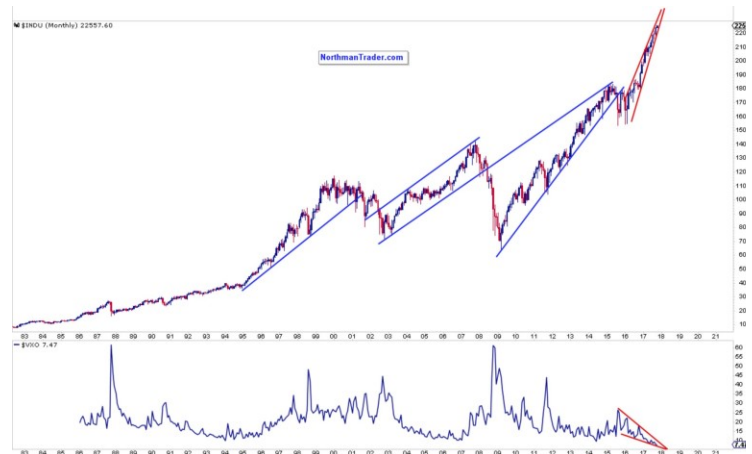


Now this is only private construction spending, if we look at public construction spending it's off the charts as governments have money that they've been able to print and they're moving forward with full force. Colleges and Universities, private schools are in the same boat and all is well there. The people we serve are seeing a big slowdown in the private sector but the entire system is being held up by the public spend. We should be seeing the opposite, a thriving private sector and a government sector that is doing what it needs to do. Living beyond their means is what government is doing today and we need to pay close attention to how this unfolds as it will not end very well, it never does.

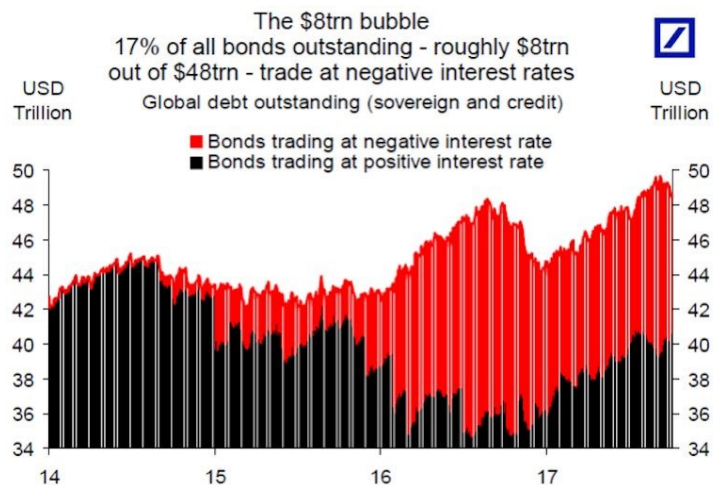
# Bubble Anatomy

We've been talking for some time now about the euphoria investors are feeling as they watch the stocks go vertical. Dangerous doesn't even come close to fully explaining what is going on here, we're witnessing sheer insanity on the part of the market participants who are foolish enough to participate.

Here are two priceless graphics to illustrate the madness of crowds. The first one shows us the general INDU index and the VIX, the fear gauge. Note the slope of the ascent recently and the decline of the VIX. There is a mean reversion that'll happen soon and we'll see these two things reverse. We're positioned for that today. This is a blow off top!



Next we move on to the bond side of the market and investors have pushed bond prices so high that yields are now negative. This means if you're buying more than the bond is worth and after the dividend payment you're losing money on the bond. This is a problem and nobody is paying any attention to it. High Yield bonds (junk bonds) are now so highly priced they're yielding under 2%. This is crazy as they normally yield 8-12% in rational times. The below shows us that 17% of all bonds out there, a total of 8 Trillion, are trading at negative rates. Folks, this has never happened, we've never seen this before, we have a lot of baby boomers with a lot of bonds that they perceive as safe. Is anyone else paying attention to this?



Source: Sukanto Chanda, Bloomberg Finance LP, DB Global Markets Research

## Inspirational Quotes

- Your life does not get better by chance, it gets better by change, Jim Rohn
- A friend is someone who knows all about you and still loves you, Elbert Hubbard
- There is only one person who could ever make you happy and that person is you, David Burns
- The words that enlighten the soul are more precious than jewels, Hazrat Inayat Khan
- The doors we open and close each day decide the lives we live, Flora Whittemore
- Men easily believe what they want to, Latin Proverb
- Your attitude is either the lock on, or the key to, your success, Denis Waitley
- A problem is a chance for you to do your best, Duke Ellington



**We can piece the puzzle together and make your money work for you!**

## Kids Korner

Rejection is just part of life and many of our youth today are so soft, so offended by anything and everything how will they deal with reality as they get older? We've got two teenage young women in the house now going through the high school years, the formative years of female development and the formidable years of kids in school who can be rough to say the least.

They're pretty good in most circumstances about anything that comes their way, they have pretty thick skin and can turn the cheek. This holiday season has brought out the snowflakes in the district as the kids try to dress up for Halloween. The administration of the school approved of their ideas but other kids were offended by the sheer concept of some outfits and the subsequent discussion in our household came down to what to do next.

We suggested just push on and do what you do, the administration has approved your idea and it's all good. In life it is impossible to please everyone and today it's impossible to please most people so we just need to be nice human beings and do our thing. The offended nonsense with our youth needs to change, these kids are living in Candyland and the sooner they wake up the better. If they cannot learn these lessons as kids it's going to be that much harder to learn them as adults as the kids are so resilient and we old folks are so set in our ways and stubborn.

If anyone you love or care about would benefit from receiving our newsletter, tell us who they are and they will be included on our mailing list. They'll certainly appreciate you thinking about them and having their best interests at heart!

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Financial Advisors

Visit us online at [www.fiscalwisdom.com](http://www.fiscalwisdom.com)

Call Toll Free (800) 843-4513  
[info@fiscalwisdom.com](mailto:info@fiscalwisdom.com)



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## Mike Chadwick’s Money Matters

15 New Britain Avenue, Unionville, CT 06085  
860.673.1942

## Chadwick Financial Advisors Place Financial Advisors

