2023 TRADES TO WATCH

2023 Trades to Watch—This is for discussion purposes only, always seek professional investment advice from a licensed advisor. This is one man's opinion.

***Recap 2022*-Last Year Comments and Performance Results….**

Although I enjoy reading market pundits' predictions for each new year, it would seem to be overkill for me to add another list to the mix. So instead, the following is my inaugural Top 10 Reversion to the Mean Trades for the New Year. Yes, I know it's late but I didn't think of it until a couple of weeks into the year. It's very important to note that these are discussion points that require much more due diligence prior to allocating your hard-earned money. Also, these are trades, not long-term investments, so keep your stop/losses tight if you decide to pursue an idea. Here we go….

When the FED pivots, someone goes through the windshield. We are starting to see some serious stocks through the window action.

1. *Everyone is long risk assets*
2. *Everyone long the same risk assets*
3. *Valuations at or above 1999 levels for almost all fundamental measures.*
4. *Leverage in the system is married to the FED's interest rate policy*
5. *Going against the consensus is easy but going against consensus and winning is hard.*

What we have witnessed in the first few weeks of 2022 is the start of a "huge hedge fund hotel" unraveling. Simply put, "hedge fund hotel" stocks occur when a large percentage of hedge funds park their money in the same group of names. The problem isn't so much when they all enter at the same time but when they all have to exit at the same time. Most hedge funds are managing for quarterly or yearly numbers, not long-term returns. After the FED poured 8x the stimulus of 2008 into the markets, the hedge funds all bought the most expensive high growth names, sending the P/E valuation on growth stocks from 18x to 33x. But they even more aggressively purchased "disruptor stocks" meaning the most expensive names that hit 10-20x sales as you can see in the excellent chart below.

Now as the FED begins a rate hike cycle, hedge funds are shifting to value names with high cash flow and inflation protected margins. This unraveling does not happen without any pain so expect to see multiple dip rallies wiped out before new lows are made. I spoke to multiple young Millennials last week that have never seen a true valuation re-set (Covid was 30days) and they were dumbfounded that Netflix could go -20% and SHOP -15% in one day. Half of the Nasdaq stocks have already experienced -40% corrections but the tough part is they are still trading at high fundamental valuations.

However this letter is not a doomsday rant, it's a reflection on the possibilities of new leadership, because as Warren Buffett says "there is always a bull market in something." Instead of the usual 10 predictions for the New Year, I am going to start a Lansing Street tradition of 10 possible reversion to the mean trades each year. These are to spark conversation and encourage a much deeper research dive on your own part before choosing to invest your money. The good news is the world has plenty of assets that are fundamentally inexpensive versus history. I fully realize some of these suggestions have been cheap for some time but there is a chance that the no earnings growth stocks have given up leadership.

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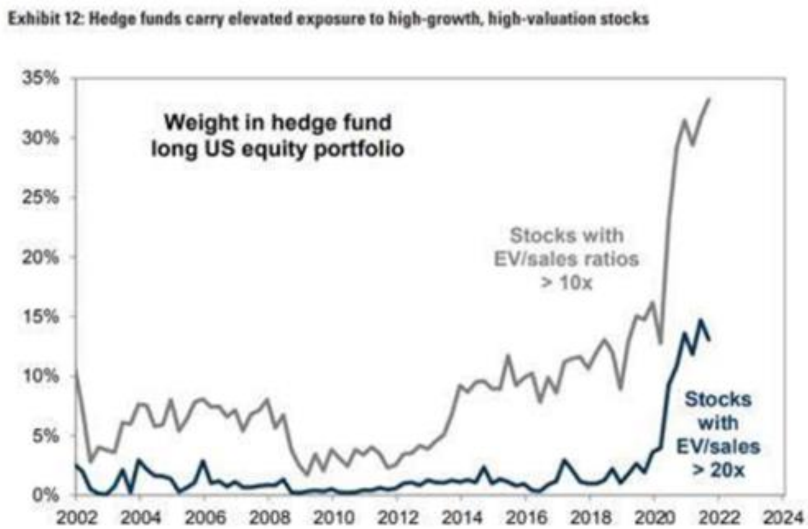
Hedge Funds go long disruptor stocks trading at 10x-20x sales when the FED took interest rates to generational low. Are they now exiting in unison? Where will the money go?



The Daily Shot Blog **https://dailyshotbrief.com/the-daily-shot-brief-january-24th-2022/**
Read my full 2022 blog post with thesis on trades from 2022 **https://matttopley.com/reversion-to-the-mean-trades/**

2022 Reversion to Mean Picks….Performance: 9 Out of 10 Beat the S&P

1. **Global Value -5% (EFV) vs. S&P -18.14%**
2. **Commodity Index +18.89% (COMT) vs. S&P -18.14%**
3. **Gold/Silver Flat -0%(GLDM and SLV) vs. S&P -18.14%**
4. **Small Cap Energy +48.5% (PSCE) vs. S&P -18.14%**
5. **Big Pharma +2.5%(PPH) vs. S&P -18.14%**
6. **Chinese Internet Stocks -17% (KWEB) vs. S&P -18.14%**
7. **Small Cap Value -9.25% (VBR) vs. S&P -18.14%**
8. **Solar Stocks -5% (TAN) vs. S&P -18.14%**
9. **Biotech Stocks -15% (BBH) vs. S&P -18.14%**

Losers -remember my "keep your stop/losses tight rules"

10. **Biggest Loser …Weed Stocks -60% vs. S&P -19.82%**

Performance numbers sourced from Yahoo finance https://finance.yahoo.com/

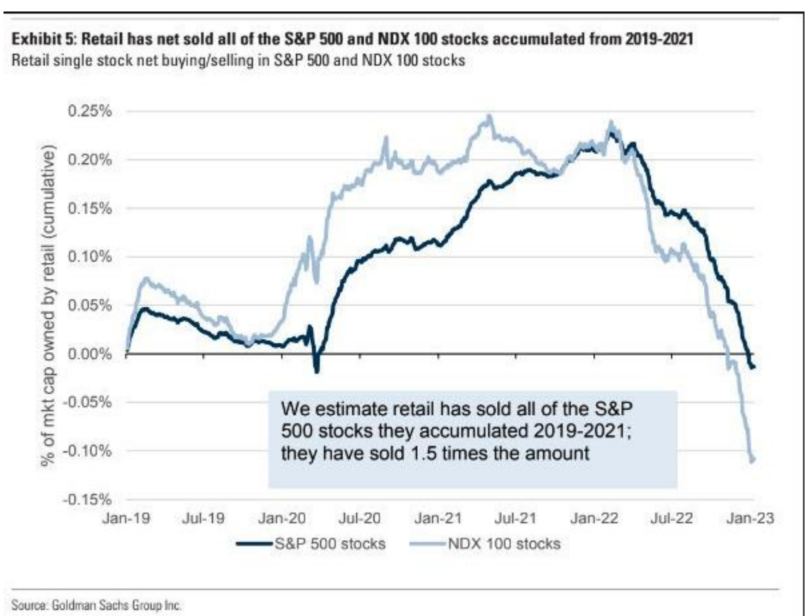
2023 Trades to Watch

As 2023 gets underway, we face a much different market than last year - stocks have corrected to 25-year median valuations. Bubble areas of the stock market are down 50-80% while left-for-dead sectors like energy outperformed the S&P by record margins. Long-duration stocks where low-interest rates and rampant investor speculation were the key inputs to the stocks' inflated valuations are left for dead. My “winners” in 2022 meant losing less than S&P.

Where does that leave us for 2023?

1. Everyone is bearish. Retail investors have dumped everything they bought at the top leaving behind disruptor stocks, crypto, IPOs, and FAANG+.
2. Retail investors are piling into U.S. treasuries and I-bonds for guaranteed returns.
3. Valuations are reasonable but not cheap for U.S. stocks.
4. Inflation and interest rates may have topped out already.
5. Negative-yielding debt has disappeared leaving bonds looking like bonds again by protecting principal and delivering reasonable rate of return.

Retail Round Trip: Seems like retail has dumped everything they bought during the heady pandemic stimulus bull/bubble(s). It goes to show, that without a decent process or overarching strategy, it often ends up a situation of "buy high, sell low". A timely reminder to take a step back and think about what you’re trying to do and how you’re going to go about it (set up well-thought-out rules and policies in advance vs just chasing the latest fad and running with the crowd).



Source: @MikeZaccardi via @MichaelAArouet from Callum Thomas Chart Storm https://chartstorm.substack.com/

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2023 Reversion to Mean Trades (9)

1. Homebuilders

Right off the bat we will go reversion to mean and contra investor sentiment by going long the homebuilders. 2023 is nothing like 2008 crisis - Americans have tons of equity in their homes with debt locked in below 4%. I am a believer that owning a home will forever be part of the American Dream. Some homebuilder stocks traded well below book value in 2022 but interest rates are trending lower, large demographic demand is in place, and builders are better at managing inventory.

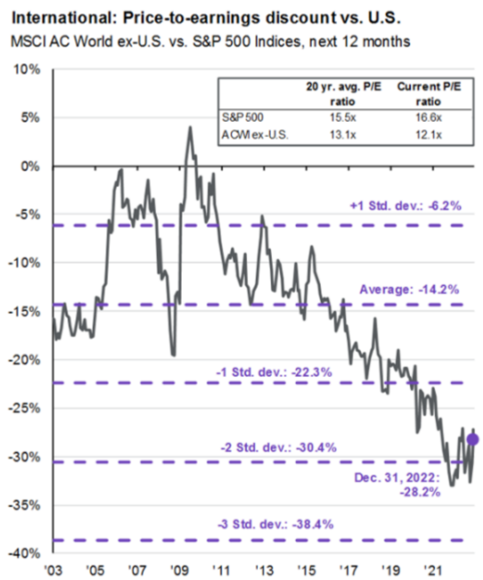
www.stockcharts.com

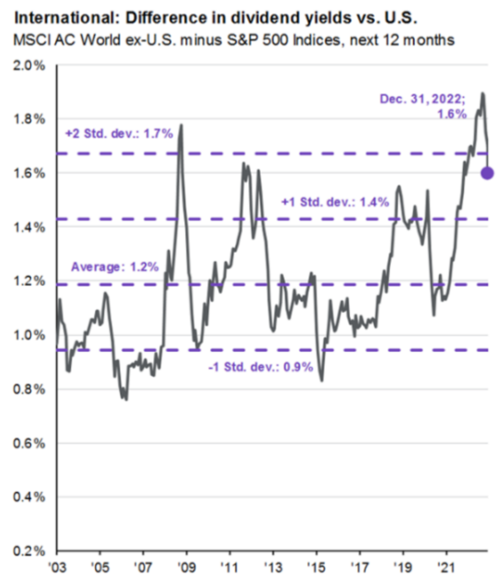
2. International Stocks

After 14 years of dramatic underperformance versus the S&P 500, international stocks outperformed over the last 6-9 months. International stocks are trading at huge discounts to U.S. stocks based on fundamentals, they are paying a significantly higher dividend rate, and technical momentum is now shifting to positive. Most important is the U.S. dollar has weakened, at the same time foreign currencies are historically cheap. International stocks are now cheap based on fundamentals, cheap currencies, and demand from investors is picking up.

This year we would start with dividend payers, add some international value, and for more aggressive investors take a position in international small cap.

JP Morgan Guide to the Markets-P/E cheap vs. U.S. and dividends higher.

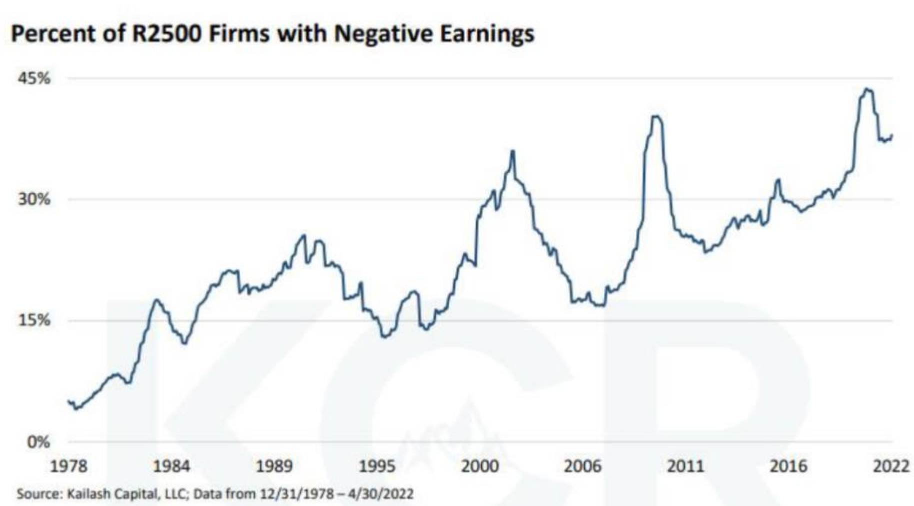




https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/?gclid=Cj0KCQiAiJSeBhCCARIsAHnAzT_-kLcvhMdcCT6TLIzalJW-J9xgnzCQ7KdOk8sHV8dLSapGngyntysaArJfEALw_wcB&gclsrc=aw.ds

3. Long Small Cap Stocks that Make Money/Short Small Caps that Lose Money.

Post the 2000 internet bubble bursting, tech stocks did not bottom until 2002 and many money-losing stocks went to zero. I was shocked to see the chart below from my friends at Kailash concepts showing more small-cap (Russell 2500) firms with negative earnings than the internet bubble. Money-losing companies that need to keep raising equity or borrowing money will struggle under a tighter credit market environment. However small cap stocks traded back to 2008 levels at their lows, small caps have underperformed the S&P during this bull market, and profitable small cap stocks outperform over the long term. To keep it simple, we will go long IJS (Small Cap Value) and short IWO (Russell 2000 growth).

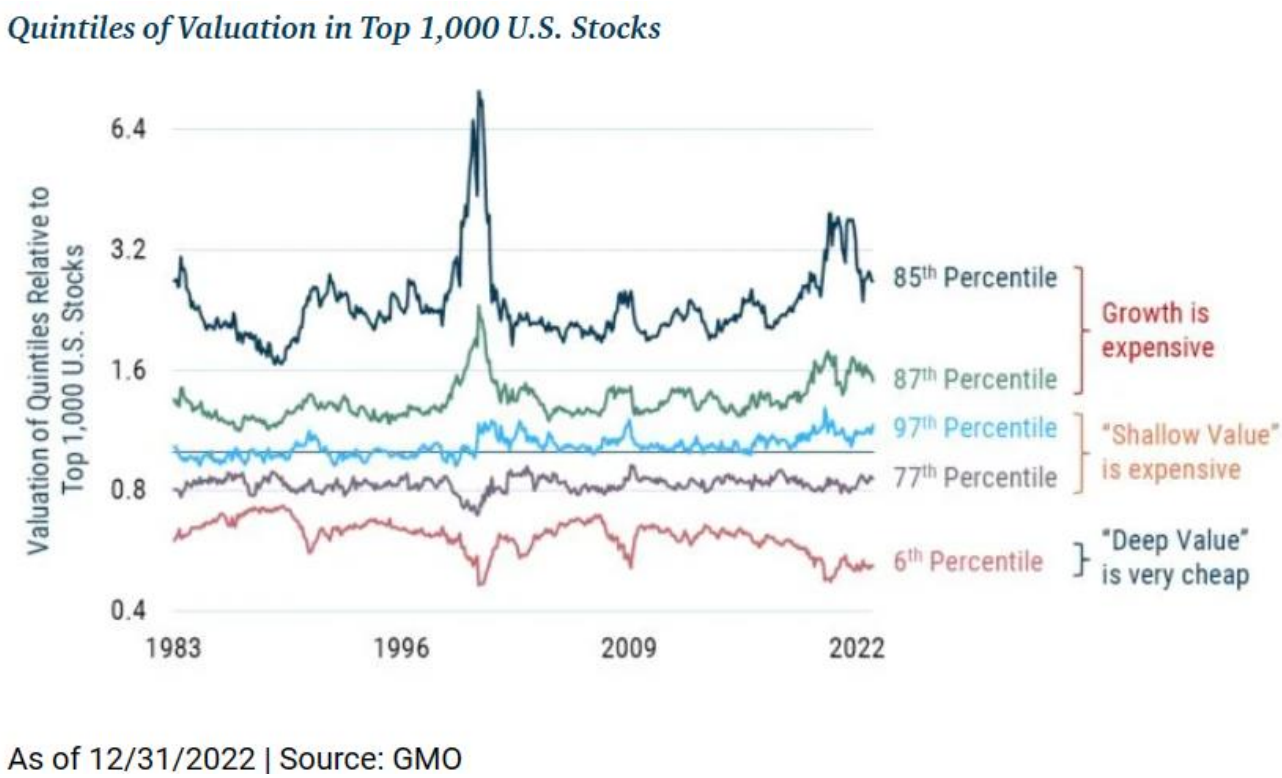


https://kailashconcepts.com/

4. Deep Value

I was searching for the best way to get exposure to the cheapest parts of the market this year and two great sources GMO Research and Barrons pointed me in the right direction. Deep value is the cheapest part of the stock market - you can get exposure through ETFs QVAL and DEEP.

Barrons-By Ben Levisohn Deep value's 2022 underperformance—in a year when value stocks outpaced the S&P 500—was an anomaly. In 2000, for instance, the S&P 500 Value index outperformed the S&P 500 by 15 percentage points, and deep value outperformed "shallow" value—the next 150 cheapest stocks after deep value in the S&P 500—by nearly 18 percentage points, according to data from GMO, which modifies some of the accounting metrics to get what it sees as a more accurate read on valuation. https://www.barrons.com/articles/exxon-mobil-chevron-gm-deep-value-stocks-51673618403



Memo to the Investment Committee: A Hidden Gem (gmo.com)

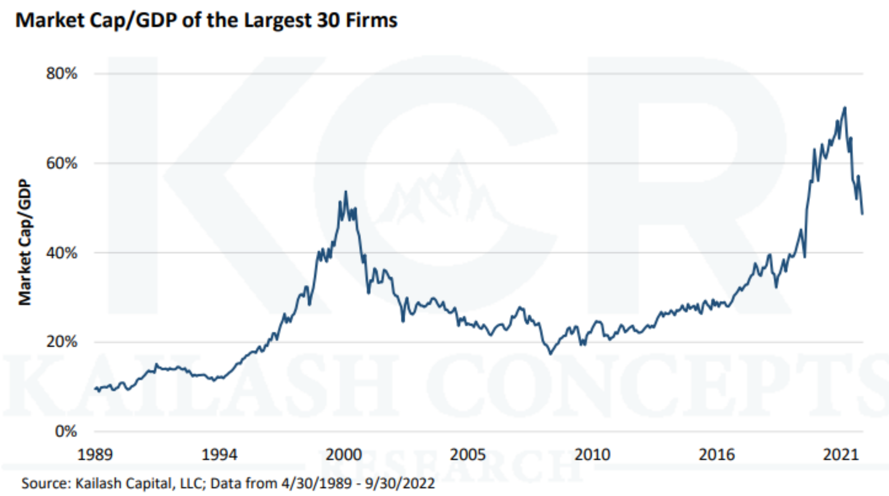
5. Equal Weight Large Cap (S&P) vs. Cap Weight.

In a market-cap-weighted strategy, you end up owning more of the larger stocks because they have a greater weight in the index. In an equal-weight strategy, you diversify it across a broader range of securities and sectors within the index.
Source: https://www.morningstar.in/posts/65315/equal-weighted-vs-market-cap-weighted.aspx

Technology stocks, especially FAANG+ became an overweighted percentage of the market cap during the 2016-2021 bull market. This reversion may not be over, so I am sticking to equal-weight S&P (RSP) vs. SPY.

From Kailash Concepts-30 stocks in the U.S. were valued at half of the country's GDP.

Does it make sense to have 30 stocks in the United States valued at half the country's GDP? It has never made sense before. Maybe it is different this time, but we doubt it.



Source: Kailash Capital, LLC; Data from 4/30/1989 - 9/30/2022

https://kailashconcepts.com/

6. Equal Weight Consumer Discretionary

Getting more granular on equal weight theme….I am a believer that Americans will always spend their money, so jumping into the second worst sector performer of 2022 with a twist. This is a hedge that we may have no recession or a mild slowdown due to the unemployment rate staying low. The key is we are going to equal weight this position as most consumer discretionary ETFs sport 20-30% combined weightings in AMZN and TSLA.

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7. Bonds - fixed income has value for the first time in years.

Bonds were expensive for years but now value has been built through rising rates. We will go up the risk scale with long high-yield bonds.

Investing prior to final rate hike has provided strong returns

BLOOMBERG U.S. AGGREGATE INDEX
(Investment six months prior to final rate hike)

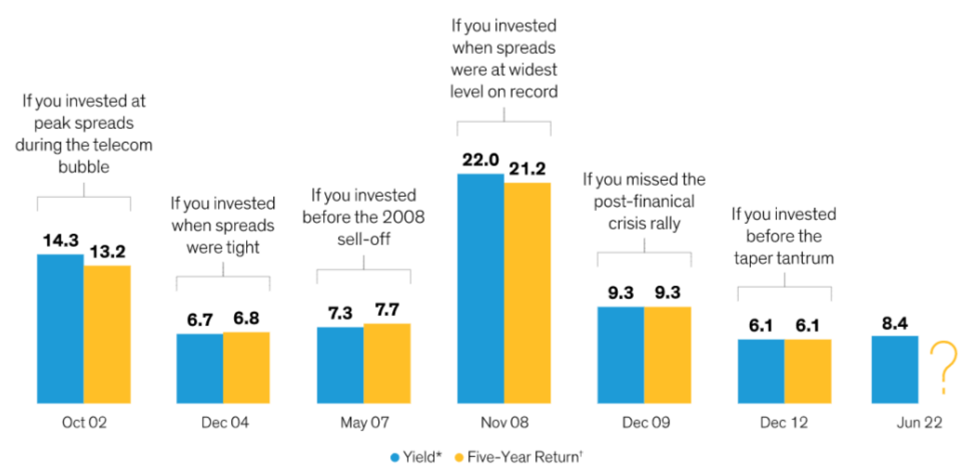
Last hike	First 12 months return (dollar cost average)	Annualized total return over five years
6/2006	4.5%	5.9%
5/2000	5.3%	7.2%
2/1995	7.7%	6.8%
2/1989	10.2%	10.6%
9/1987	7.0%	9.6%
5/1981	3.3%	15.6%

https://www.capitalgroup.com/advisor/insights.html

High-Yield Bond Returns High Correlation to Coupon-Alliance Bernstein

Five-Year Returns Have Closely Tracked Yield at Start of Period

Starting Yield to Worst and Five-Year Forward Annualized Return: Bloomberg US Corporate High Yield Index
Percent



Historical and current analysis and forecasts do not guarantee future results. An investor cannot invest directly in an index, and its performance does not reflect any fees and expenses or represent the performance of any AB fund.

As of June 27, 2022

*Yield to worst as of date shown

†Annualized five-year return beginning on date shown

Source: Bloomberg and AB

https://www.alliancebernstein.com/corporate/en/insights/investment-insights/three-reasons-its-time-to-add-high-yield-bonds.html

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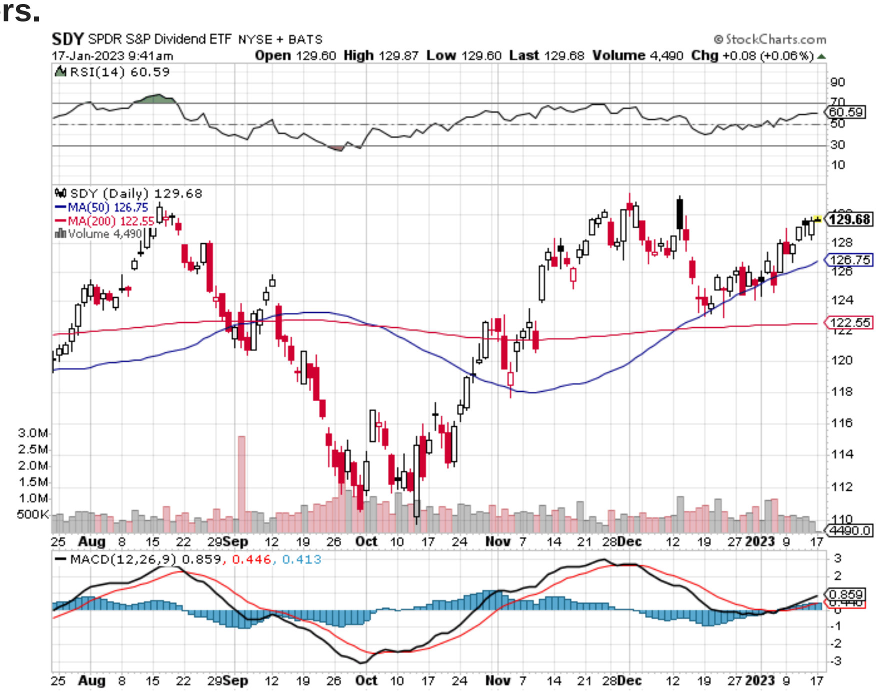
8. Chinese Internet Stocks—Repeat Pick from 2022.

This trade has bad karma like my weed stock pick from last year because I am not a fan of communist so this it goes against my core beliefs. This is a "keep your stop/loss tight" trade.

www.stockcharts.com

9. Dividend Growers - Another Repeat from 2022.

Simple thought process that dividends will continue to lead in 2023, growth at all costs is sidelined for another year as solid balance sheets and dividends outperform. See your investment professional, I am not advocating any product but multiple choices between ETFs and active managers.



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