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Strategy Spotlight

Capitulation Still Hasn't Been Seen

The big thing you need to know: In this edition of *Strategy Spotlight*, we review the latest updates to two weekly investor sentiment indicators that we are tracking, which in the past have helped confirm major bottoms in US equities. These are CFTC's data on asset manager positioning in US equity futures (released Friday), which captures institutional investor sentiment, and AAII's weekly bull-bear poll (released Thursday), which captures retail investor sentiment. Both have taken bearish turns over the last few weeks, but neither has returned the extremes seen in past comparable periods of investor stress. We continue to think it's premature to call a bottom in the S&P 500 (or an end to the extreme period of volatility that we are in). Our view remains that the S&P 500 is experiencing a growth scare, similar to what occurred in 2010, 2011, 2015–16, and 4Q18. In those downdrafts, recession was avoided, but investor anxiety over entering one ran high and the index fell 14–20% peak to trough (see pages 2–4 of our February 27th *Strategy Spotlight* for details). A comparable drop today would take the S&P 500 into the 2,700–2,900 range. If we are wrong, it will be because stocks are starting to anticipate a recession, where the average and median drop has been 32% and 24%, respectively, since the 1930s. That kind of drop would take the S&P 500 into the 2,300–2,600 range.

Institutional investor sentiment has plunged but remains well above 2018, 2016, 2011, and 2009 lows: See Exhibit 1 for our latest update on asset manager positioning in US equity futures, based on CFTC data. The mid-February high was the most euphoric reading on record, surpassing the peaks of 2007, January 2018, September 2018, and July 2019. The latest data point captures positioning as of 3/3/2020, the day the stock market fell sharply in response to the Fed's surprise emergency cuts. Despite dropping significantly for two weeks in a row, this indicator remains well above its December 2018, 1H2016, 3Q2011, and March 2009 lows. If the current pace of decline were to continue, it would take at least another two weeks for this indicator to return to its March 2009 and December 2018 lows, which were a bit shallower than the 2011 and 2016 lows.

Within retail, bears held steady: See Exhibit 8 for the latest update on bullishness and bearishness in the American Association of Individual Investors (AAII) weekly survey, and Exhibit 9 for trends in the four-week average gap. Bears held steady at 39.6%, virtually unchanged from the prior week's reading of 39.1%. In recent years, as well as around LTCM and the 9/11 terrorist attacks, bears have moved into the 45–50% area before topping out. The gap between the bulls and bears also tends bottom out in the -19% to -20% area using a four-week average, as it did in January 2016, December 2018/January 2019, and August 2019. In early 2009 during the Financial Crisis, the four-week average gap got a bit worse, hitting a low of -36%. As of 3/5/2020, the bull-bear gap was at -0.9%, with the four-week average still tracking at a positive 4.3%.

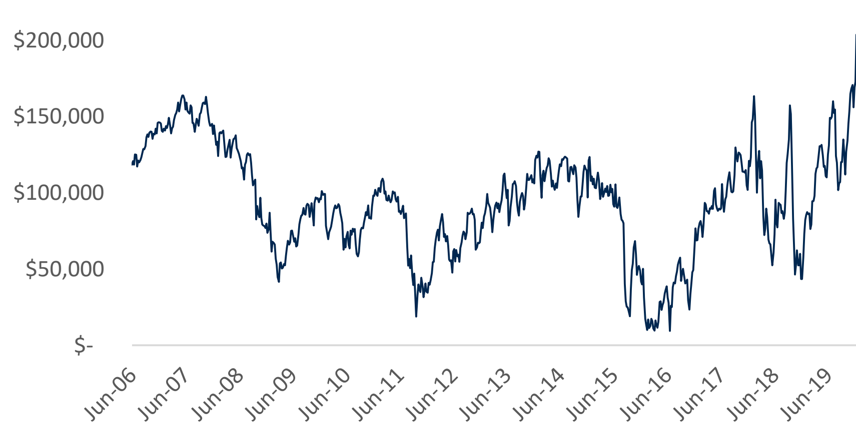
Capitulation Hasn't Been Seen Yet

Institutional Investor Sentiment Has Plunged but Remains Well Above 2018, 2016, 2011, and 2009 Lows

We are keeping a close eye on CFTC's data on asset manager positioning in US equity futures, which we view as a valuable, nearly real-time gauge of institutional investor sentiment. This indicator, which is reported weekly, has plunged in the last two updates after hitting a new all-time high on February 18. The mid-February high was the most euphoric reading we have on record, surpassing the peaks achieved in 2007, January 2018, September 2018, and July 2019.

The latest data point, released late Friday, captures positioning as of 3/3/2020, the day the stock market fell sharply in response to the Fed's surprise emergency cuts. Although it fell 31% in the most recently reported week, and 26% in the week before that, it still remains well above its December 2018, 1H2016, 3Q2011, and March 2009 lows. If the current pace of decline were to continue, it would take at least another two weeks for this indicator to return to its March 2009 and December 2018 lows, which were a bit shallower than the 2011 and 2016 lows.

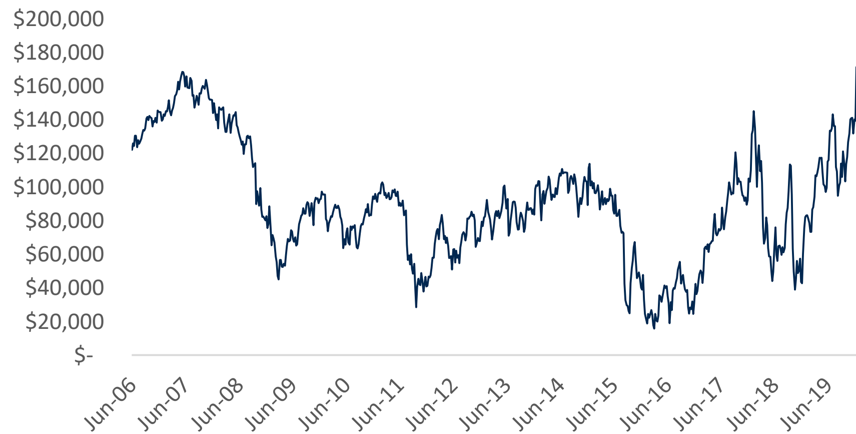
Exhibit 1: Asset Manager Net Long Position for US Equity Futures (USD, MM)



Source: RBC US Equity Strategy, Bloomberg, CFTC. As of 03/03/2020

Note that within the aggregated model, S&P 500 futures positioning has been falling from levels a bit above 2007 and significantly above early 2018 highs. Like the broader model, S&P 500 futures positioning still has considerable distance to travel before returning to the 2009, 2011, 2016, and 2018 lows.

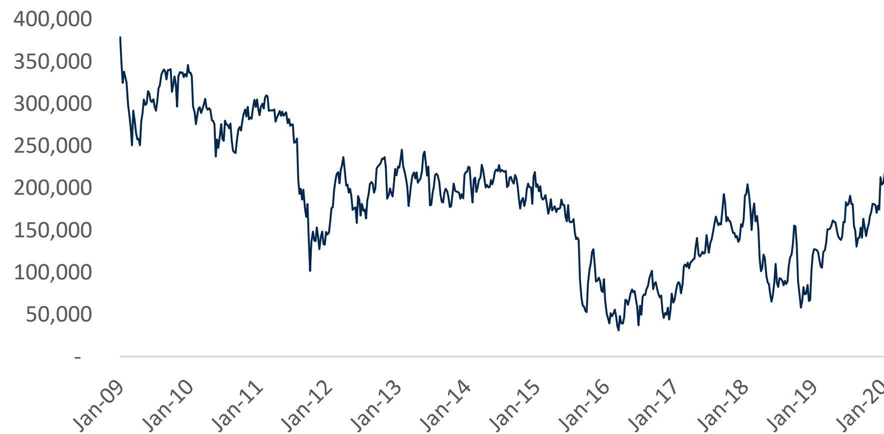
Exhibit 2: Asset Manager Notional Net Long Position for S&P 500 Equity Futures ($USD, MM)



Source: RBC US Equity Strategy, Bloomberg. As of 03/03/2020

The previous charts depict trends in net notional Dollar value, which takes into account both the number of contracts and price levels. There's no change in our conclusions if we focus on the number of contracts instead. For the S&P 500, the number of contracts fell 26% week-over-week in the last update and 21% in the previous week, for a total drop of 41% from the February 18th high, which happened to be right in line with the ceiling that's been in place since 2012.

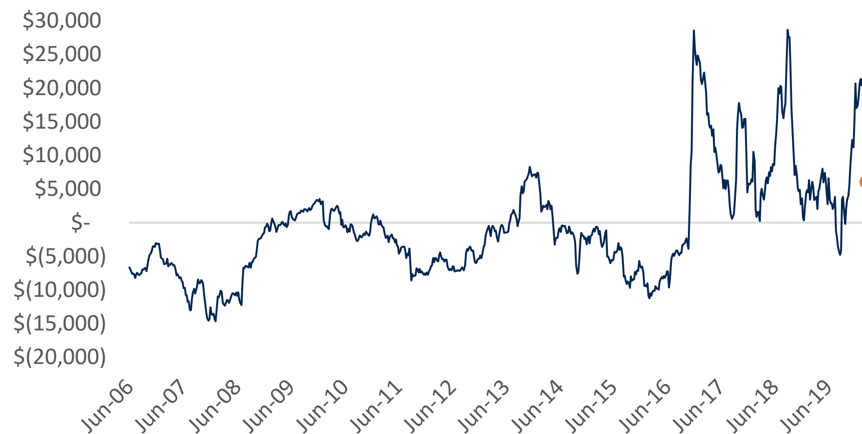
Exhibit 3: Asset Manager Net Long Position for S&P 500 Equity Futures (Number of Contracts, MM)



Source: RBC US Equity Strategy, Bloomberg. As of 03/03/2020

Looking elsewhere within the model, Russell 2000 futures positioning (net notional dollar value) continued to decline in the last update. It's substantially below its early February 2020 peak, which was close to its December 2016 and January 2018 highs. It remains well above its September 2019, 1Q2016, 2Q2011, and 1Q2008 lows, which were all in net short territory.

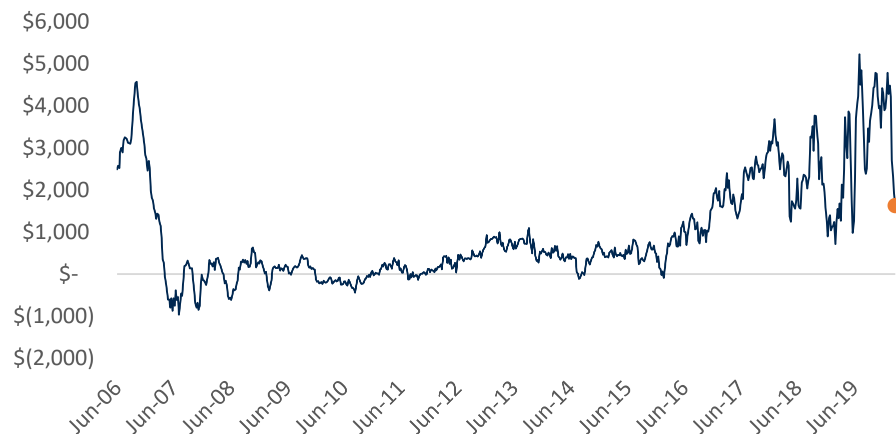
Exhibit 4: Asset Manager Notional Net Long Position for RTY Futures ($USD, MM)



Source: RBC US Equity Strategy, Bloomberg. As of 03/03

Dow futures continued to drop in the latest update. Prior lows of this particular indicator have been less consistent than for the broader US equity market, the S&P 500, and the Russell 2000. It's still worth noting that Dow futures have made some decent progress toward their own 2019 lows.

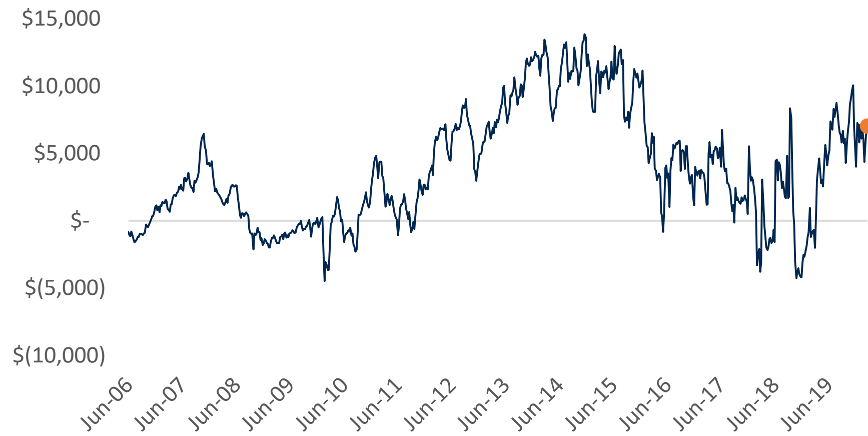
Exhibit 5: Asset Manager Notional Net Long Position for DOW Futures ($USD, MM)



Source: RBC US Equity Strategy, Bloomberg. As of 03/03/2020

Meanwhile, Nasdaq futures have been oddly resilient and are only modestly below their own late-2019 highs. This syncs up with performance trends in our TIMT-heavy hedge fund Hot Dogs list (most popular S&P 500 stocks in hedge funds), which has been very resilient in terms of relative performance recently, unlike during the second half of 2018, when it underperformed significantly. For now, what we're seeing in the Nasdaq futures positioning and the Hot Dogs performance trends suggests that professional investors aren't shunning their favorite secular growth names as we'd expected would be the case in the next period of substantial equity market derisking.

Exhibit 6: Asset Manager Notional Net Long Position for NDX Futures ($USD, MM)



Source: RBC US Equity Strategy, Bloomberg. As of 03/03

Exhibit 7: Hedge Fund Hot Dogs (S&P 500 Stocks, Most $ Value Owned by Hedge Funds) Relative Performance to S&P 500 Index

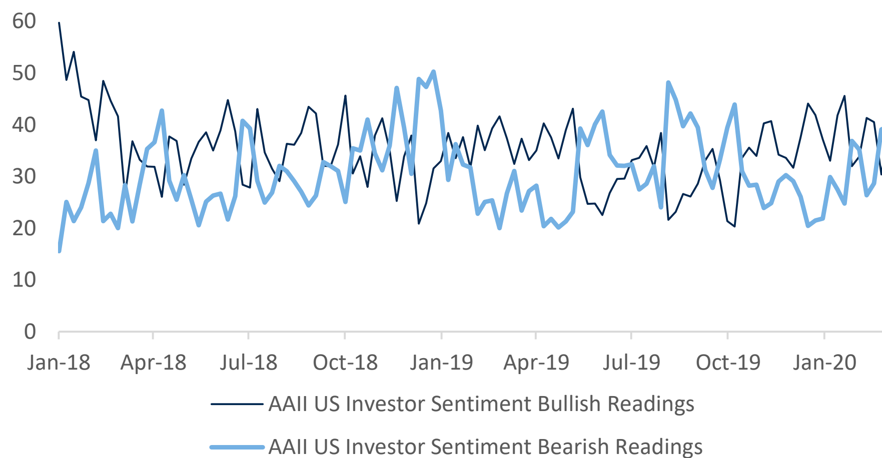
Source: RBC US Equity Strategy, Capital IQ. As of 03/04/2020

Within Retail, Bears Held Steady

We are also keeping a close watch on the weekly survey conducted by the American Association of Individual Investors (AAII), which captures retail investor sentiment. Surprisingly, bulls actually rose a bit in the latest update (from 30.4% to 38.7%). Bears held steady at 39.6%, virtually unchanged from the prior week's reading of 39.1%.

In recent years, as well as around the LTCM crisis and the 9/11 terrorist attacks, bears have tended to move into the 45–50% area before topping out. During the Financial Crisis and its immediate aftermath, bearishness admittedly did become a bit more extreme, moving up into the 60–70% area.

Exhibit 8: AAII US Investor Sentiment – Bullish and Bearish (January 2018 to Present)



Source: RBC US Equity Strategy, Bloomberg, AAII. As of 03/05/2020

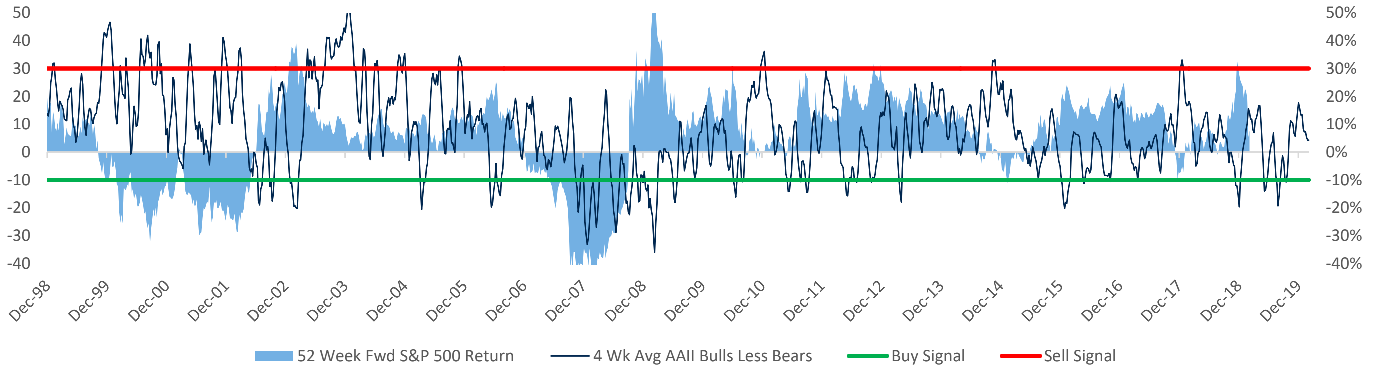
We continue to think that AAII bears would need to make a move to at least 45% before a conversation can legitimately take place about whether capitulation has been seen by retail investors.

We'd also like to see the gap between the bulls and bears fall into the -19% to -20% area using a four-week average, as it did in January 2016, December 2018/January 2019, and August 2019. On the exact weekly data points, the bull-bear gap fell into the -26% to -27% area in each of these periods. In early 2009 during the Financial Crisis, the gap got a bit worse, hitting -36% on a four-week average. Bears topped out in absolute terms on a weekly basis around 70%.

As of 3/5/2020, the bull-bear gap was at -0.9%, with the four-week average still tracking at a positive 4.3%. Note that when the gap falls below -10%, the S&P 500 has been higher 12 months later 83% of the time (dating back to 1987), with an average gain of 11.8%.

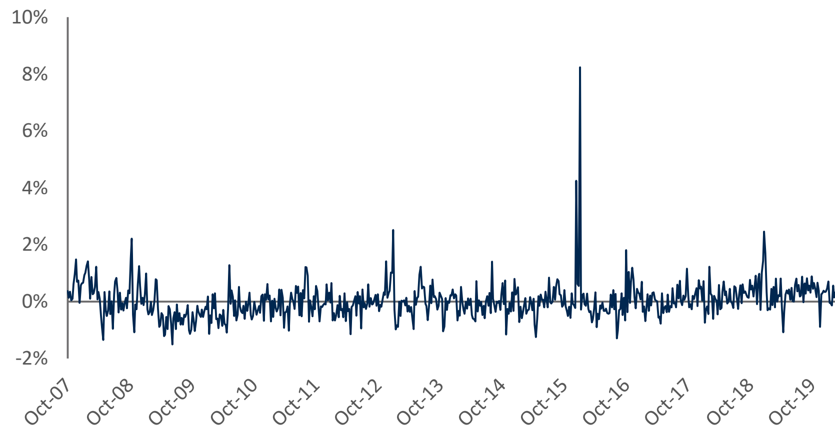
One place where we have greater signs of retail investor stress is in the weekly update from the Investment Company Institute on the level of assets in money market funds, among retail investors specifically. In its latest update, which is as of March 4, 2020, the level of AUM spiked 2.1% over the past week. A similar move was last seen in the week ended December 26, 2018, when retail money market AUM spiked by 2.6%. This is not sufficient, in our opinion, to call a short-term bottom in stocks, however. 2016 saw an even bigger spike, of more than 9% in the week ended January 6.

Exhibit 9: AAII Bulls Less Bears (4-Week Average)



Source: RBC US Equity Strategy, AAII. As of 03/05/2020

Exhibit 10: Weekly Percentage Change in Retail Money Market Fund Assets



Source: RBC US Equity Strategy, Investment Company Institute (ICI), Haver. As of 03/04/2020

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