NETRA

Early Warning & Signals Through Charts

June 2022

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Run Your Life On Principles

In this 1st anniversary edition of NETRA we present to you
Bob Farrell's 10 Timeless Investing Rules through live data charts

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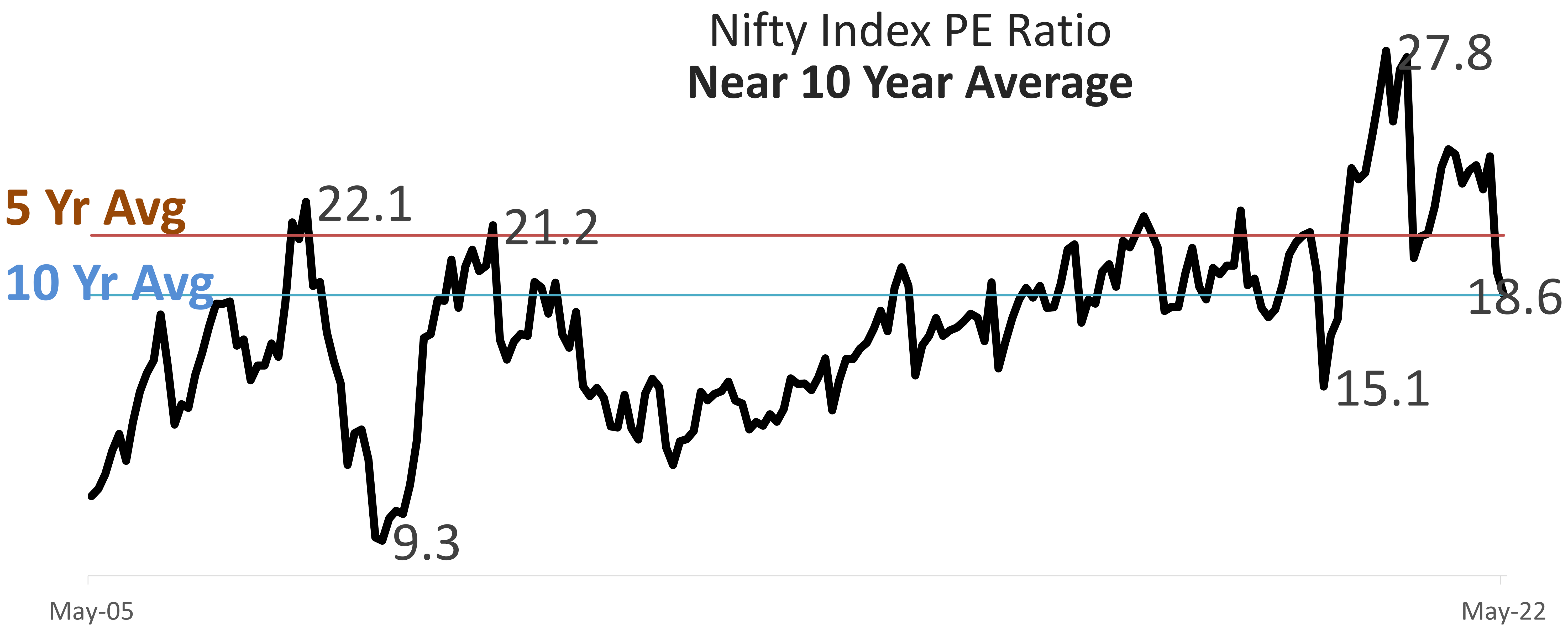
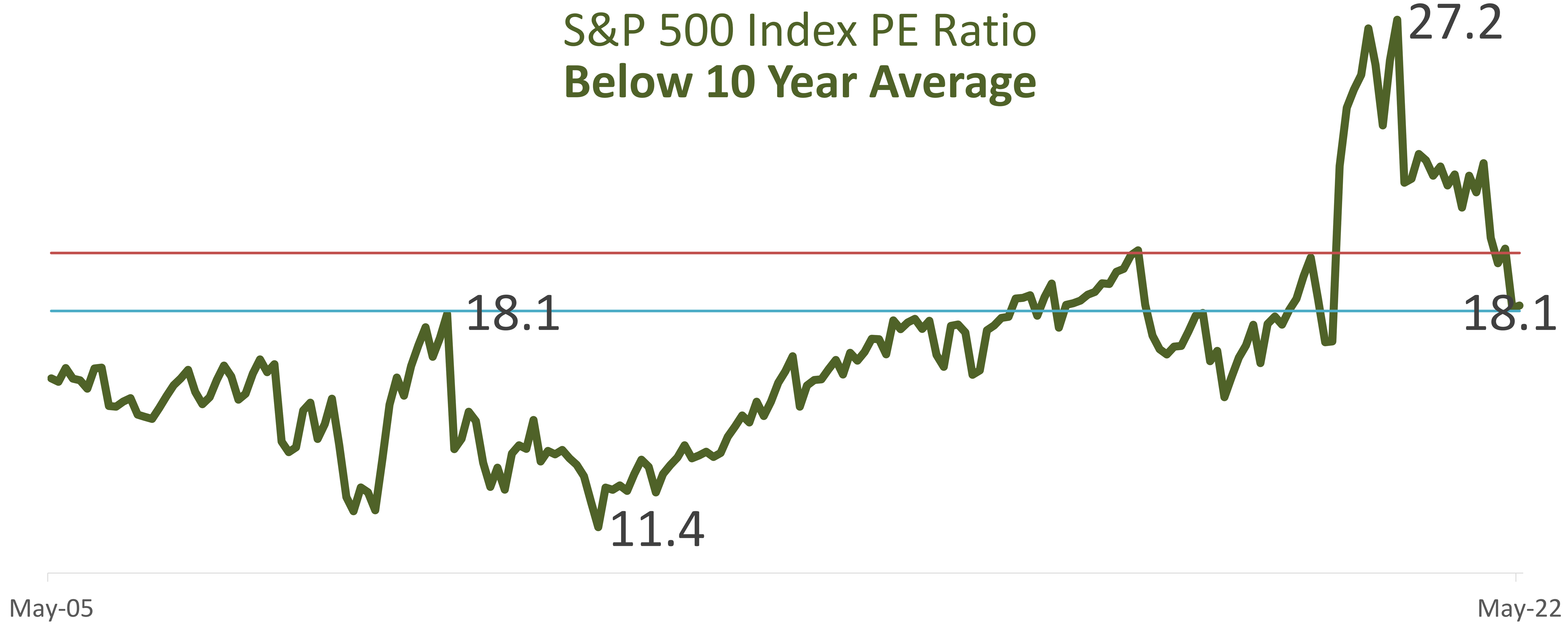
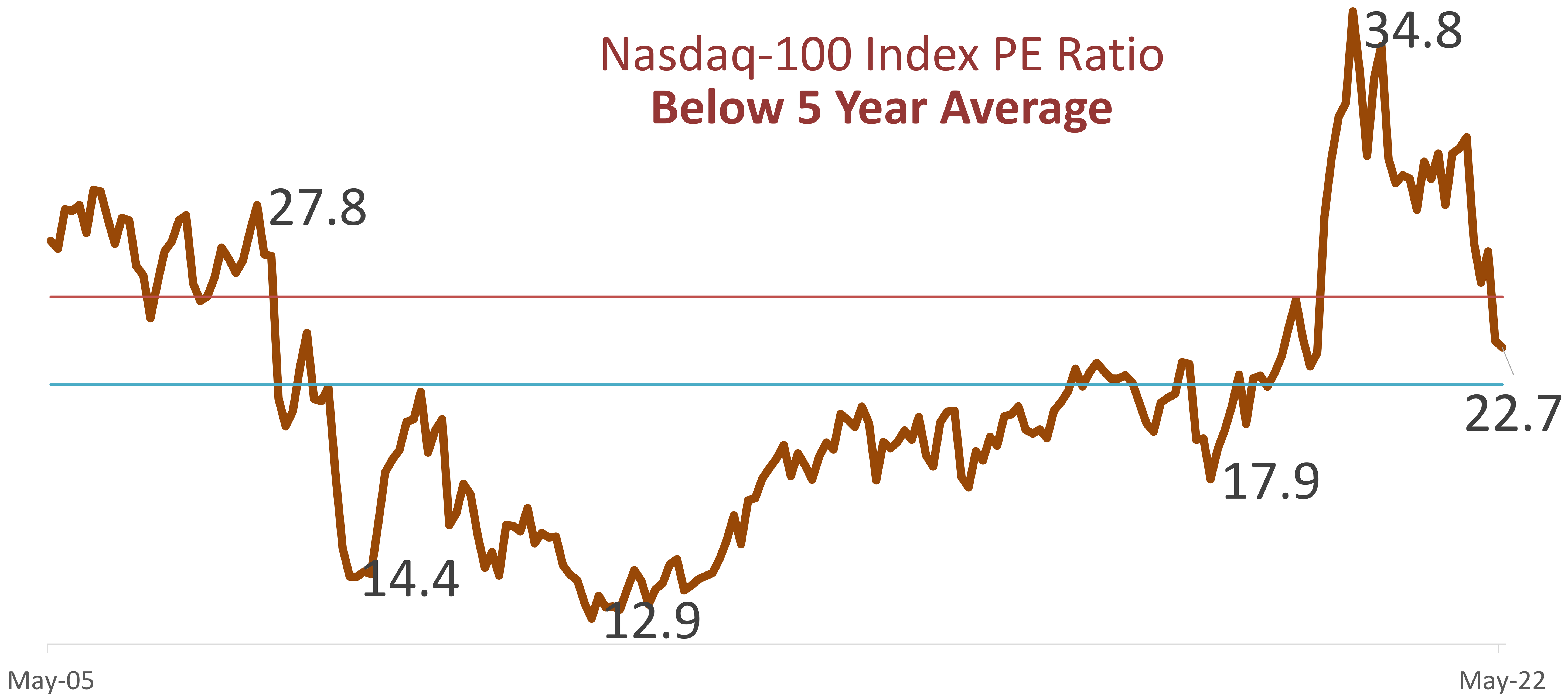
Bob Farrell’s 10 Timeless Investing Rules

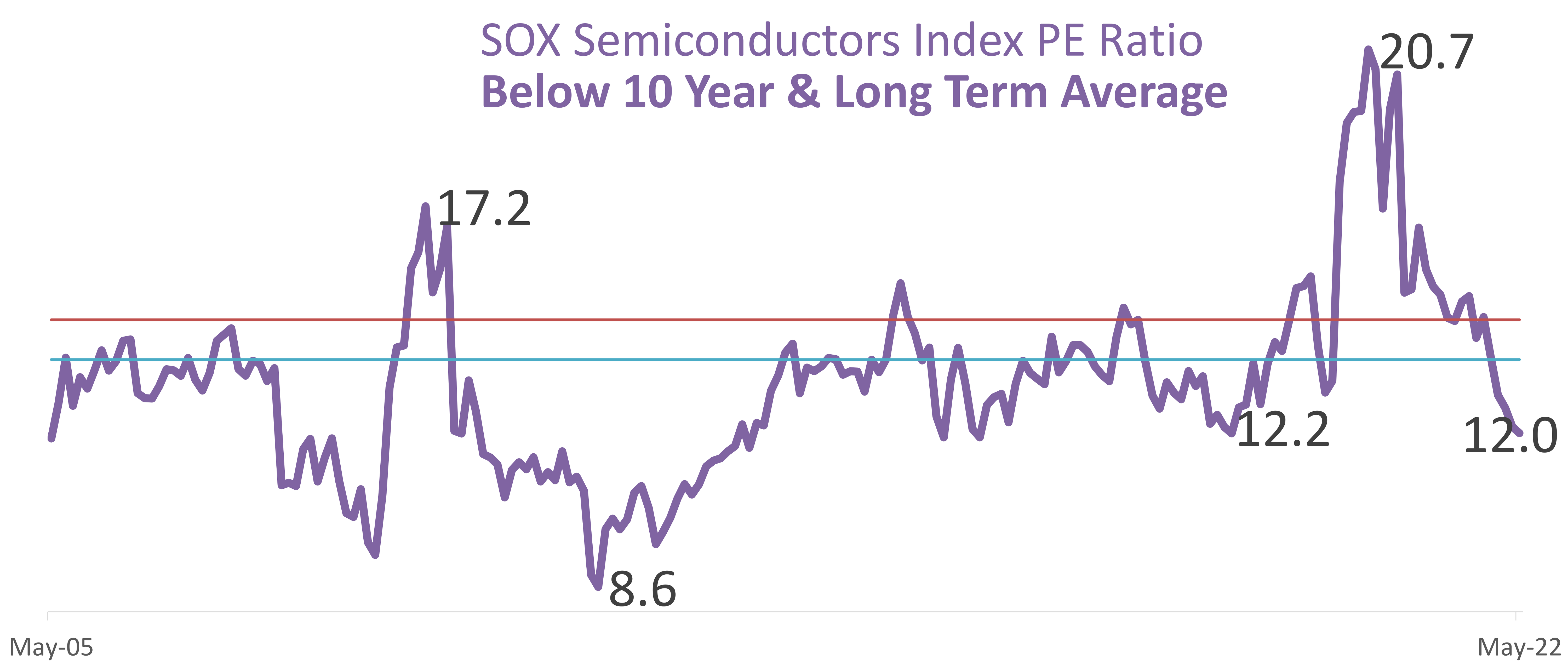
1. Markets tend to return to the mean, over time
2. Excesses in one direction will lead to an opposite excess in the other direction
3. There are no new eras - excesses are never permanent
4. Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways
5. The public buys the most at the top and the least at the bottom
6. Fear and greed are stronger than long-term resolve
7. Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names
8. Bear markets have three stages - sharp down, reflexive rebound and a drawn-out fundamental downtrend
9. When all the experts and forecasts agree - something else is going to happen
10. Bull markets are more fun than bear markets

Markets Tend To Return To The Mean Over Time









Source: Bloomberg, Data As of 27th May 2022

Excesses In One Direction Will Lead To An Opposite Excess In The Other Direction

The NYMEX WTI Crude Oil 321 crack spread measures the difference between the purchase price of crude oil and the selling price of finished products, such as gasoline and distillate fuel (diesel), that a refinery produces from crude oil.

Crack spreads are an indicator of the short-term profit margin of oil refineries because they compare the cost of the crude oil inputs to the wholesale prices of the outputs.

The 3:2:1 crack spread approximates the product yield at a typical U.S. refinery: For every three barrels of crude oil the refinery processes, it makes two barrels of gasoline and one barrel of distillate fuel hence the ratio 3:2:1

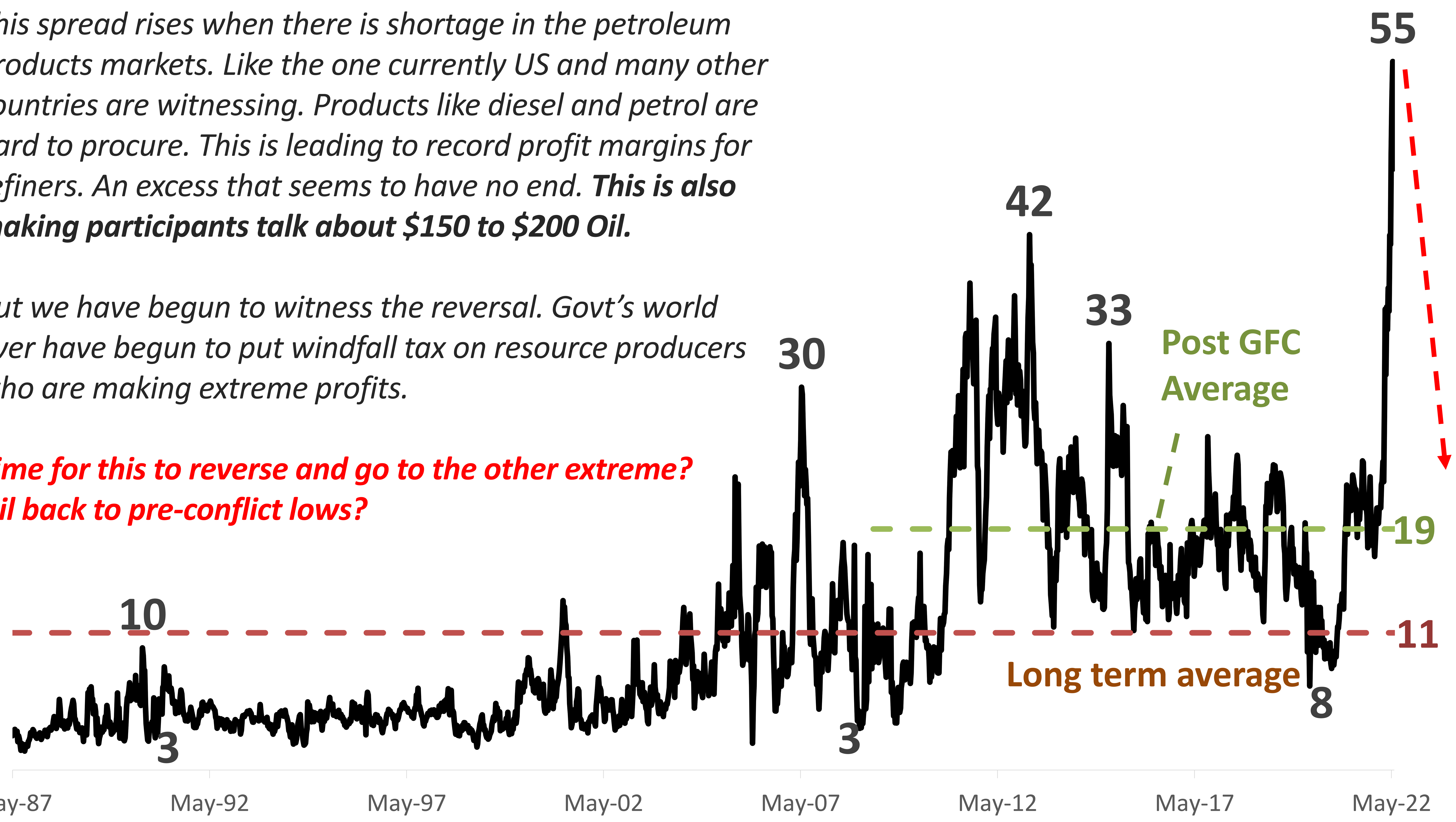
Formula:
(2 X Gasoline + 1 X Distillate Fuel) – 3 X Crude Oil= Crack Spread (also a proxy for GRMs)

Nymex WTI Crude Oil 3:2:1 Crack Spread Gone Berserk

This spread rises when there is shortage in the petroleum products markets. Like the one currently US and many other countries are witnessing. Products like diesel and petrol are hard to procure. This is leading to record profit margins for refiners. An excess that seems to have no end. ***This is also making participants talk about $150 to $200 Oil.***

But we have begun to witness the reversal. Govt's world over have begun to put windfall tax on resource producers who are making extreme profits.

Time for this to reverse and go to the other extreme? Oil back to pre-conflict lows?



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Source: Bloomberg, Data As of May 27th, 2022

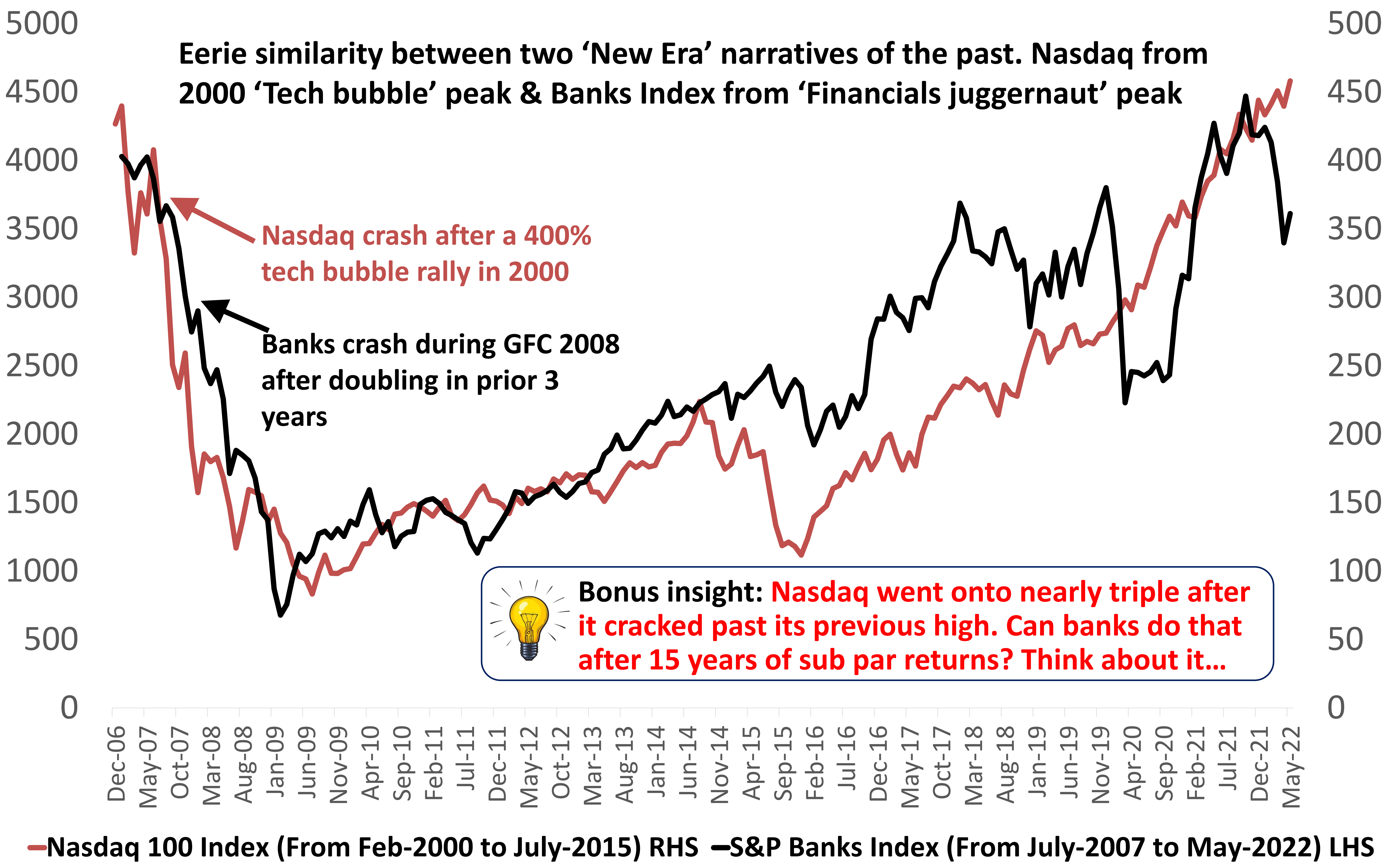
There Are No New Eras: Excesses Are Never Permanent

Prior to the 'Tech bubble' it was believed that technology will append everything we know and the 'tech sector stocks' will remain in a long, multi decade bull market.

Prior to the financial crisis it was believed that by using the modern methods of slicing and dicing of risk the financial industry has unlocked the holy grail of profitability and risk diversification.

Alas there are no new eras. In the last 5 years we have seen the pendulum swings for many such themes.

Current 'New Era' theories are: Commodity Supercycle, Permanently High P/E ratios… you can add your theory to this list.



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Source: CMIE, Data As On May 2022

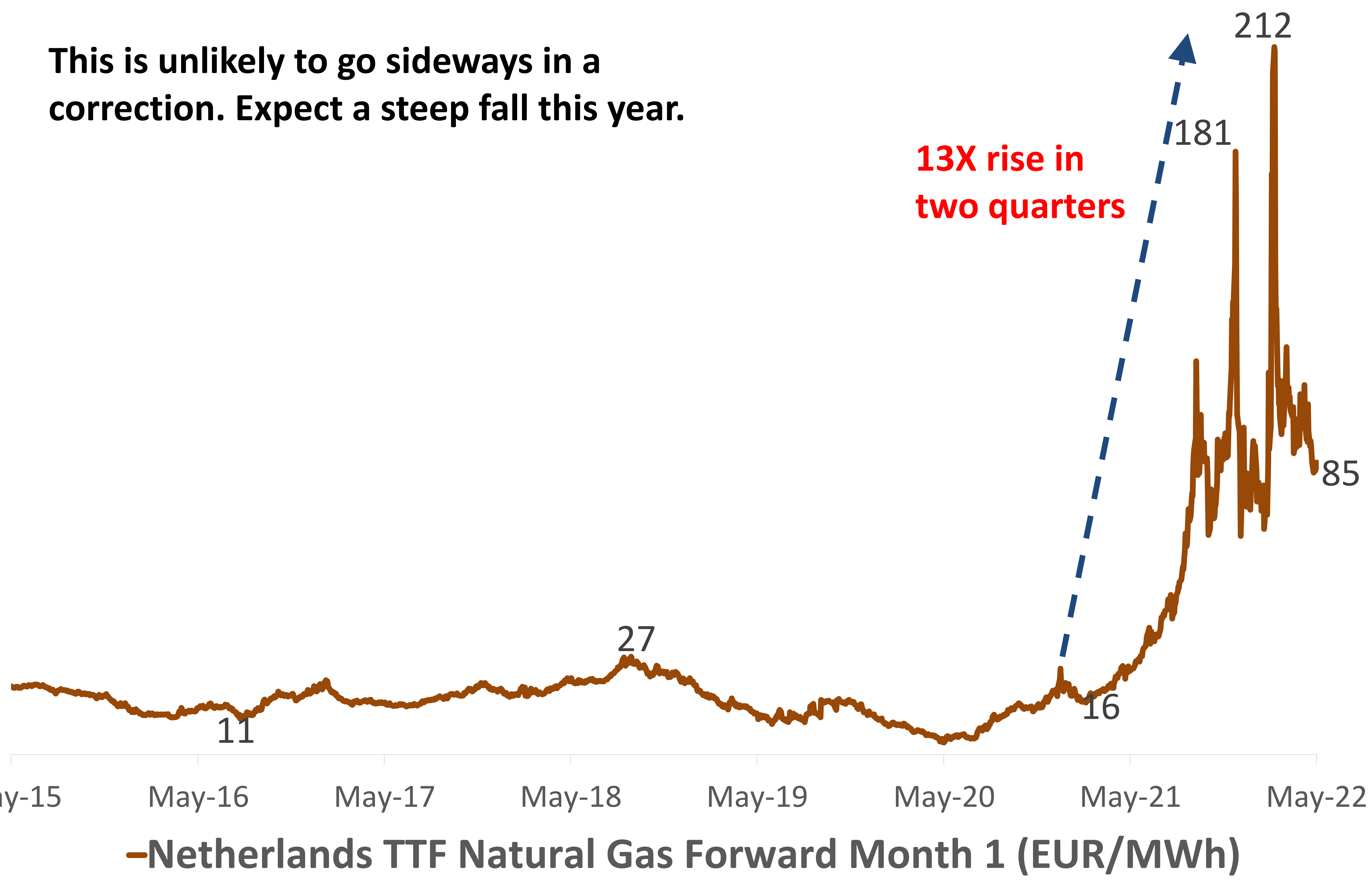
Exponential Rapidly Rising Or Falling Markets Usually Go Further Than You Think, But They Do Not Correct By Going Sideways

The biggest disruption in 2022 has been in the energy markets in Europe. Especially the natural gas markets has gone through a very large supply side crunch.

The Dutch TTF Natural Gas prices went from under 16 to 212 Eur/MWh over the last few months. Recently the prices have begun to fall swiftly.

There is a consensus that due to the Russia-Ukraine issue, demand revival and long term underinvestment the natural Gas prices in Eurozone are likely to remain high for years.

However history tells us that prices don't move sideways after rising exponentially. So expect a crack in Natural Gas prices this year. This will be positive for energy using sectors like industrials, transportation and automotive.



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Source: Bloomberg, May 2022

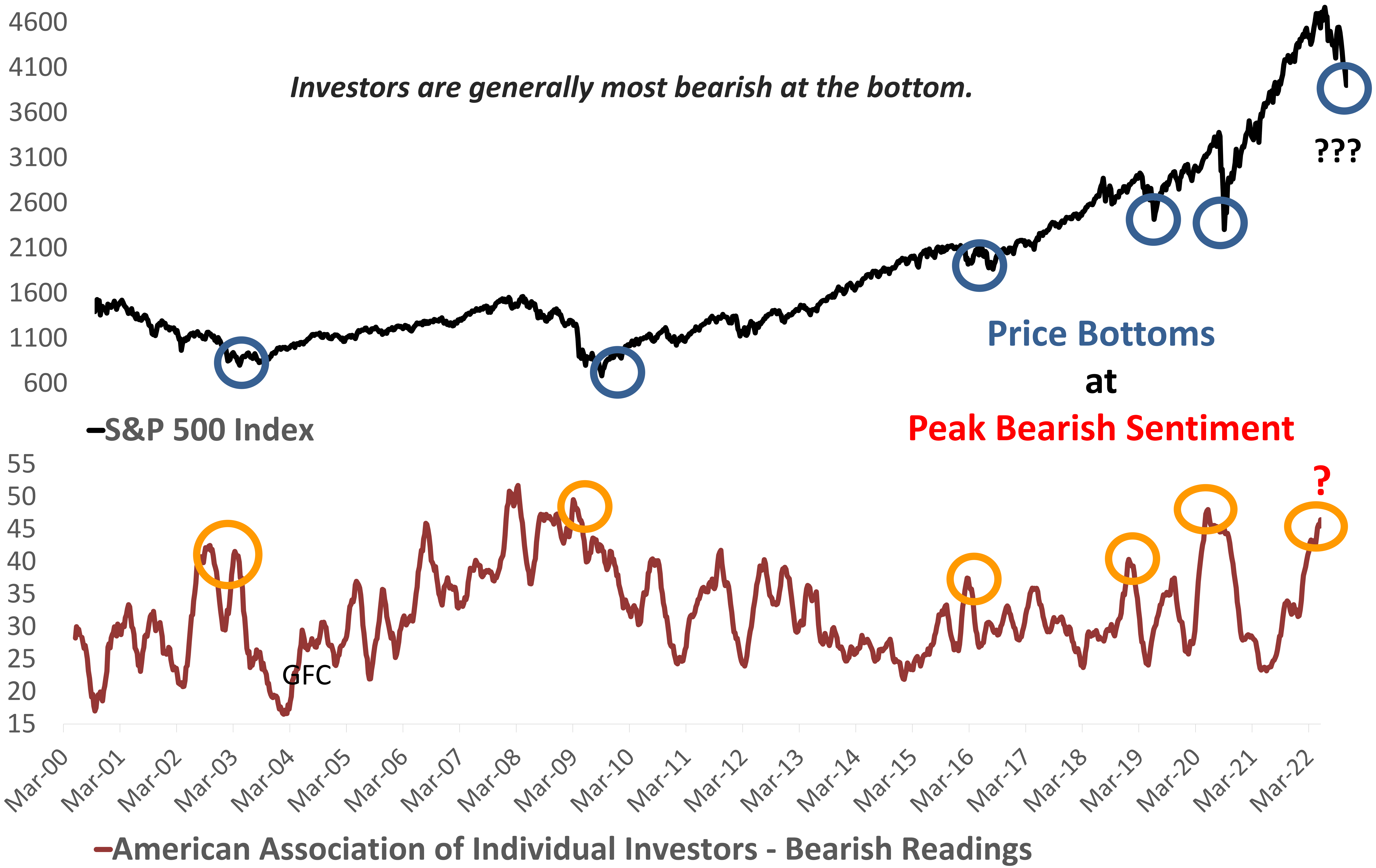
The Public Buys The Most At The Top, And The Least At The Bottom

Every week, AAII asks investors a question:

Do you feel the direction of the stock market over the next six months will be up (bullish), no change (neutral) or down (bearish)?

Combined with other indicators like valuations, earnings trends, momentum and intermarket relationships this indicator is a very useful contrarian indicator.

It reflects, as it is doing now, that investors are too bearish about market's outlook over the next 6 months. There is a wall street saying: 'Public is mostly right but wrong only at the turn'.



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Source: Bloomberg, Data as on May 2022

Fear And Greed Are Stronger Than Long-term Resolve

Energy input is a large part of airlines cost and impact profitability. Energy prices are volatile.

The ratio of a Indian market leader in the airlines sector and crude oil futures price at MCX gives an idea of how greed and fear functions in this cyclical industry. Every time oil prices have rallied the airlines sector stock prices have crashed. Interestingly the majority of selling and downgrades come close to the turning points.

Do we know the turning points or is it just hindsight? Over the last seven years the chart on the right has bottomed closer to 0.2. This is the point of maximum fear and represents a good risk reward.

Be attentive to focus on airlines stocks. Go bottoms up & find the best priced businesses.

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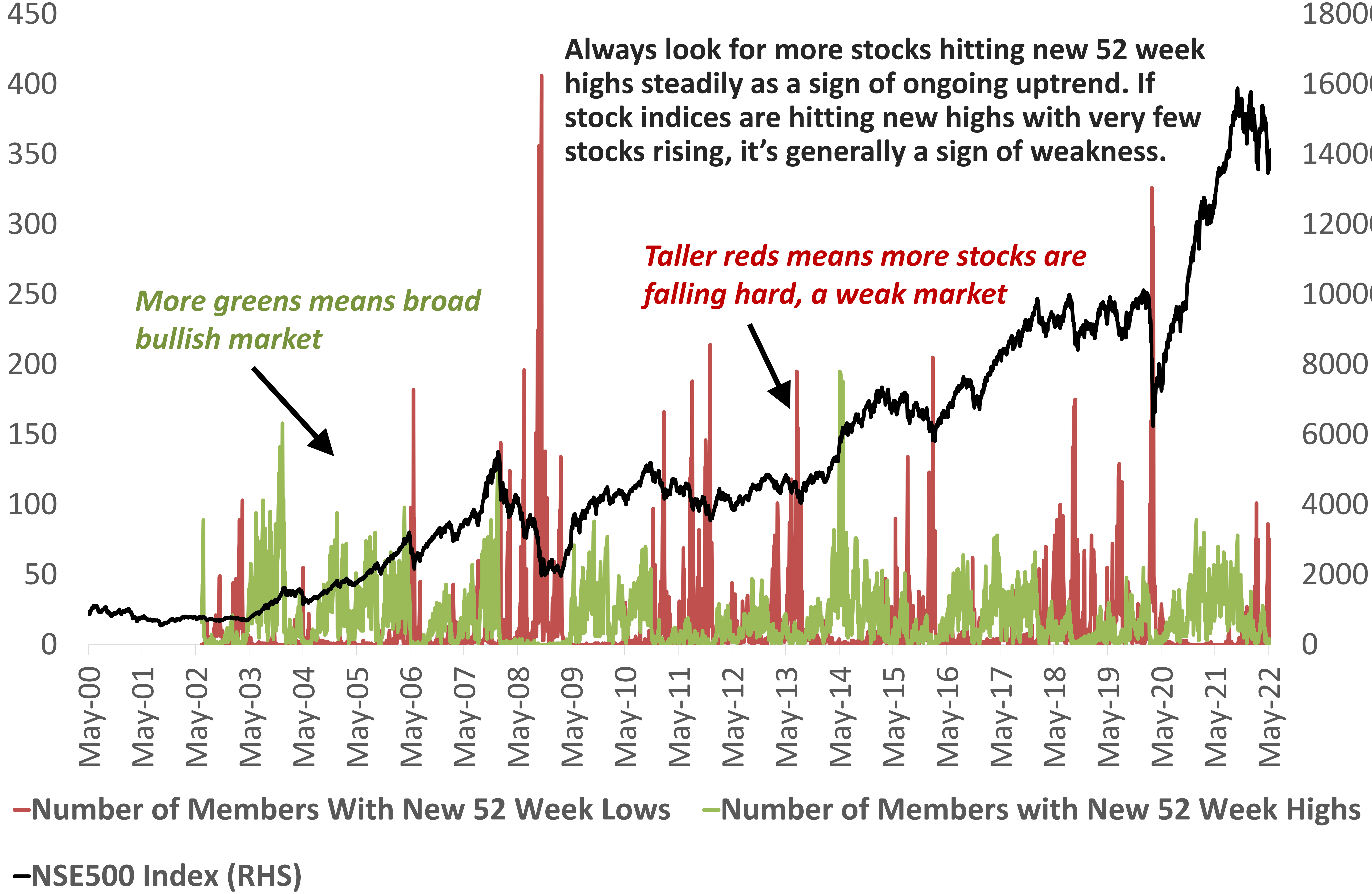
Source: Bloomberg, Data as on May 2022

Markets Are Strongest When They Are Broad And Weakest When They Narrow

Always look for more stocks hitting new 52 week high steadily as a sign of ongoing uptrend. If stock indices are hitting new highs with very few stocks rising, it's generally a sign of weakness.

Why? When more stocks participate in the uptrend it reflects stronger underlying risk appetite and possibly better fundamentals if supported by broad earrings growth.

The post pandemic rally has characterized by more stocks rising together. Look for this sign again in H2 of 2022. this will add to conviction that markets have bottomed out in May 2022.



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Source: NSE, Bloomberg, Data as on May 2022

Bear Markets Have Three Stages: Sharp Down, Reflexive Rebound & A Drawn-out Fundamental Downtrend

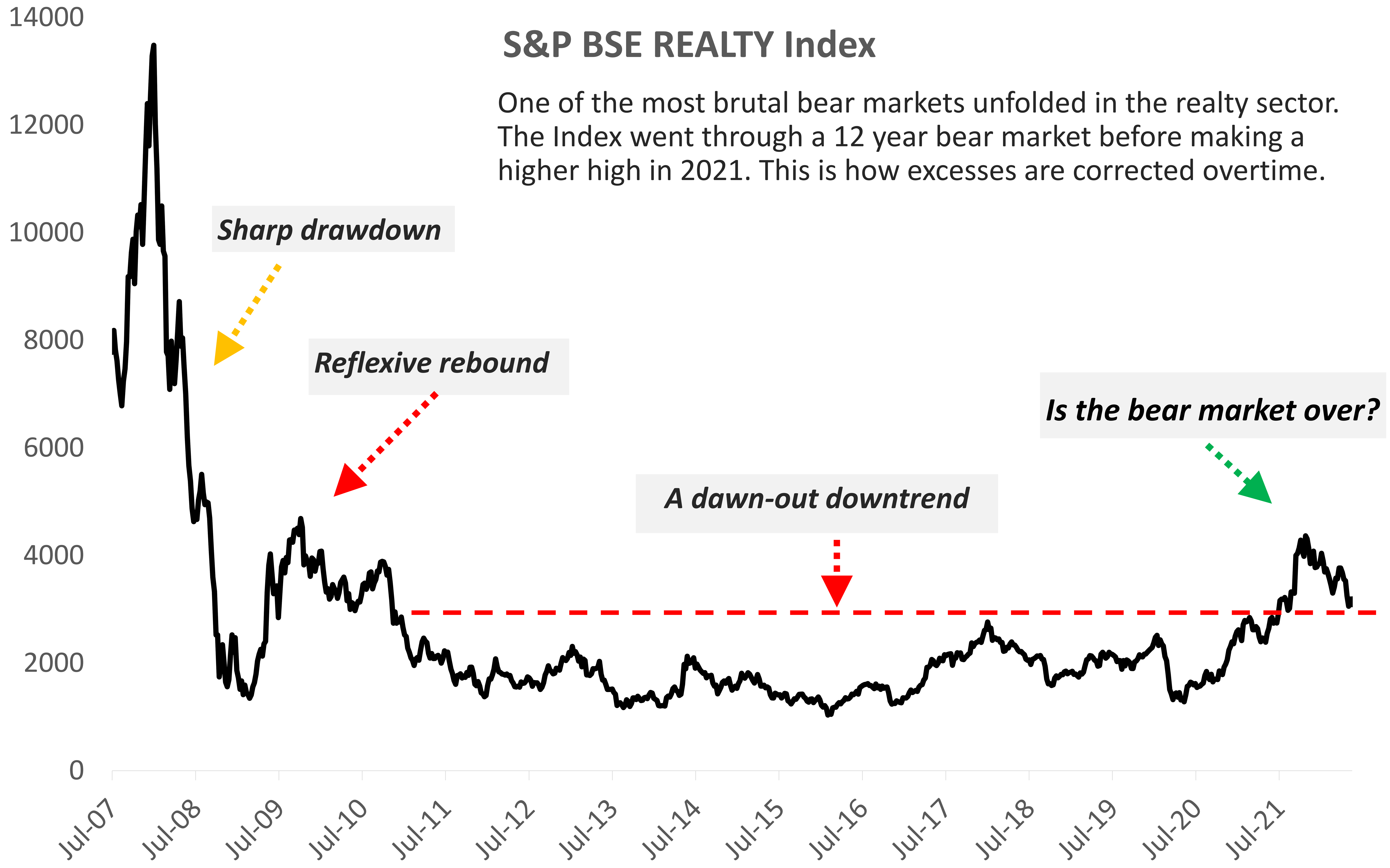
The real estate sector has gone through a 12 year bear market.

Bear market often start with a sharp and swift decline. After this decline, there is an oversold bounce that retraces a portion of that decline. The decline then continues, but at a slower and more grinding pace as the fundamentals deteriorate.

It does appear that this long drawn-out bear market in realty sector ended in 2021 when the index made a higher high versus its highs made since 2010.

Insight: Don't rush when fashionable stocks crack.

The trend probably changed recently and a new bull market in realty took birth. This is bullish for real estate stocks in India.



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Source: Bloomberg, Data as on May 2022

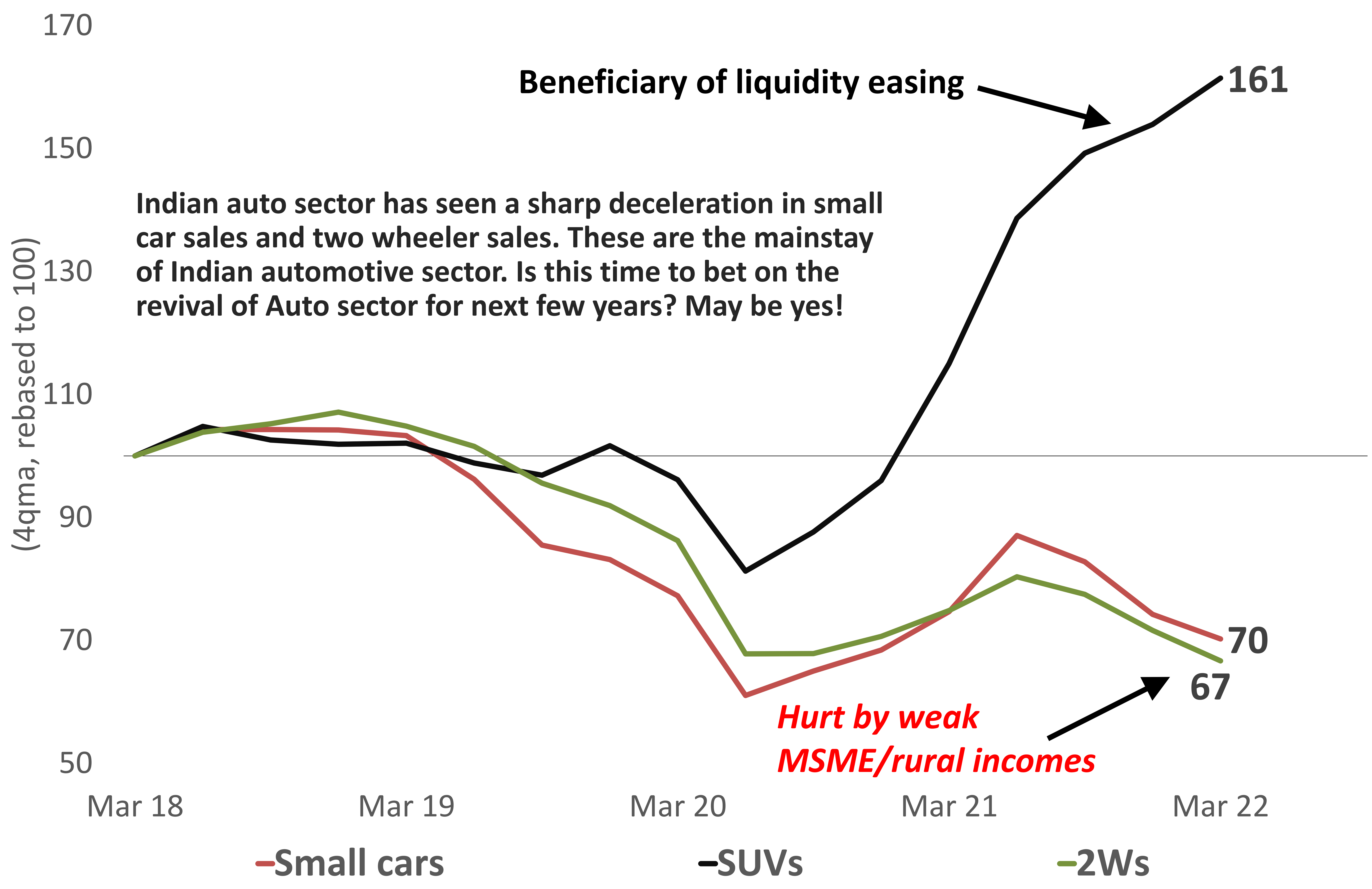
When All The Experts And Forecasts Agree, Something Else Is Going To Happen

India's auto sector has been hurt quite a lot. Semiconductor unavailability, poor rural revival, repeated lockdowns over the last two years and large outflows from the sector has caused Nifty Auto Index to not perform over the last 5 years.

The two large segments of India's auto sector – small cars and two wheelers – have been under stress. Recently the commentary has turned even more bearish and uncertain for these two segments.

Most investors and analyst have no clear signs of how auto sector will perform over the next few years.

There is a good chance that something else is doing to happen – Auto outperformance.



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Source: Edelweiss Research, Data as on May 2022

When All The Experts And Forecasts Agree, Something Else Is Going To Happen

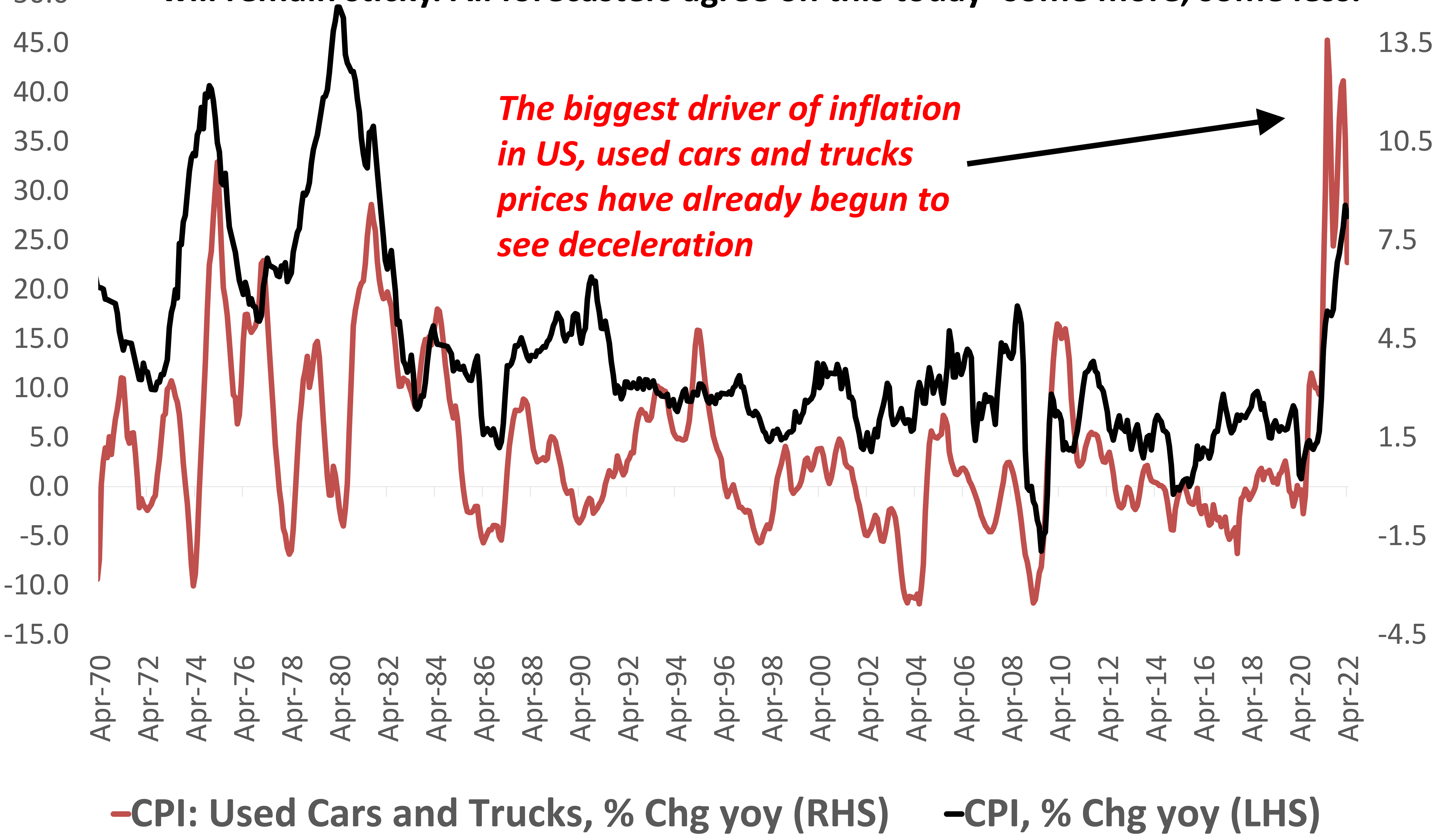
Inflation is the hottest topic across the world at this time. US consumer price inflation (CPI) is at 8.3%, the highest level in last 40 years.

There is a very broad consensus among forecasters and policy makers that inflation is headed higher.

But we have seen this in the past that reality surprises. What seems most apparent seldom happens.

Can inflation soften against the consensus ?

The biggest consensus in the world today is- inflation is headed higher and will remain sticky. All forecasters agree on this today- some more, some less.



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Source: St Louis Fed, FRED Data as on May 2022

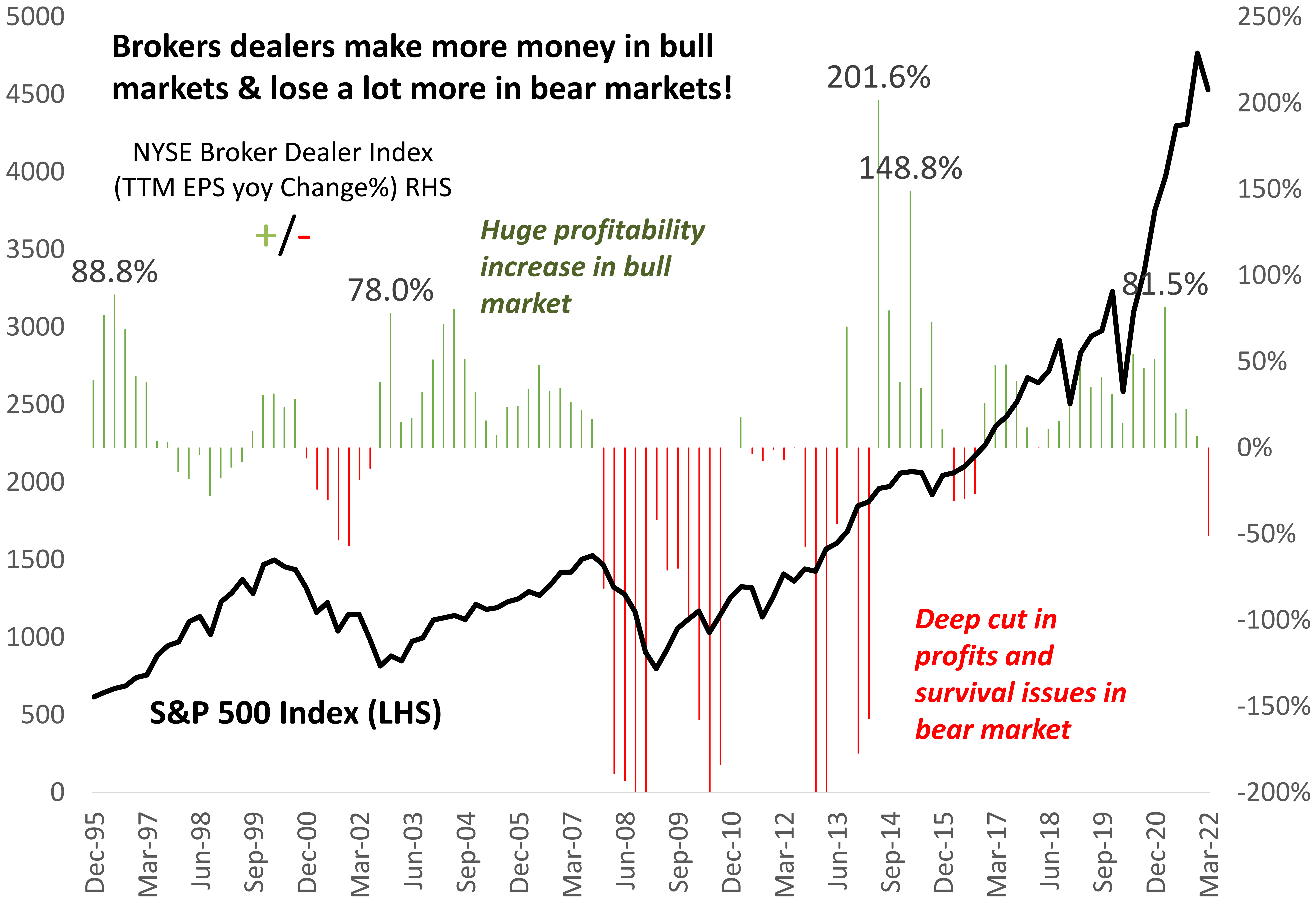
Bull Markets Are More Fun Than Bear Markets

The financial industry and investor community are geared towards bullish markets.

In bull markets most participants make exceptionally strong profits, especially those involved in the buying/selling of securities, the broker dealers.

This repeats in every cycle. That's why most commentary is always bullish. It's more fun for everyone.

But what's really important is that the best portfolio returns are made by navigating tough bear markets and through systematic investments.



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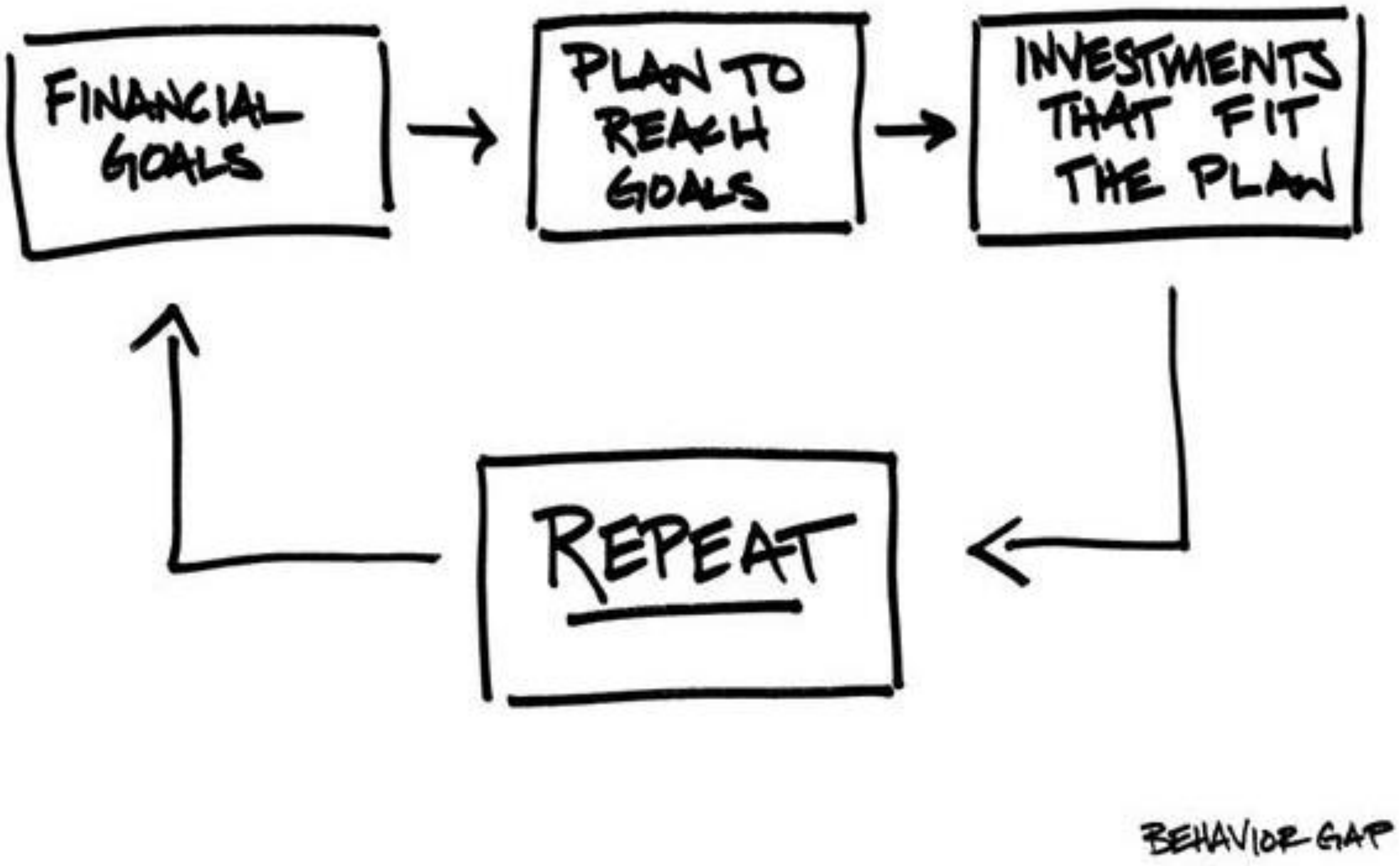
Source: Bloomberg; Data as May 2022

Process

Set Rules,
Follow,
Achieve.

Set higher goals.



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