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Liquidity Research Suggests The End Of The Bull Market Is In Sight

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Charles Biderman, president of Liquidity TrimTabs.com Investment Research, Inc., suggests that the bull market we have enjoyed all these years may be coming to an end. His research offers brilliant insight into how we might use liquidity analysis to gauge the market's direction. TrimTabs.com is the only independent research service that publishes in-depth daily and weekly coverage of stock market liquidity. The tracking of money flows, in and out of the U.S. stock market, is important as the aggregate price of all stocks is primarily a function of liquidity, having little to do with value.

Academicians maintain that stock prices and liquidity are coincidental indicators, which means that if one knows where liquidity is heading, one will know where the stock market is headed. Liquidity analysis is the key to understanding why and how markets move. While liquidity research does not tell you whether Intel is worth more than Microsoft or about emotional factors that can move the market, liquidity determines how strongly news will affect stock prices. High liquidity can spur the market significantly higher when other indicators are positive and cushion the fall when indicators are negative. By watching liquidity, investors are often ahead of the market and will never be far behind.

HISTORICALLY, BULL MARKETS END FOR ONE REASON AND ONE REASON ONLY: THE SUPPLY OF SHARES EXCEEDS THE DEMAND

Historically, bull markets end for one reason and one reason only: the supply of shares exceeds the demand. Liquidity analysis is the only way we know how to determine when a bull market will end. Liquidity was bullish through the end of last year, but that has changed starting this past November and continuing so far this year.

There are two aspects to stock market liquidity analysis. One is the change in the trading float of shares, and the second is the cash available to buy those shares. The float has been growing big time since November. New offerings – consisting of initial public offerings, secondaries, convertible bonds, convertible preferreds, ADR's sold in the U.S. but does not include closed end funds – set a record in November at $34.5 billion. January, normally the slowest month for new offerings, saw over $20 billion sold – the second biggest month ever.

What's more, insiders sold at least $30 billion worth of shares in December, triple the rate of December 1998. Estimates by Liquidity TrimTabs.com indicate that insiders in the year 2000 will be selling over $30 billion of converted options and direct holdings of never-before sold shares each and every month until the market cracks. That data is based upon analyzing option conversion data from the top U.S. market caps and #144 insider selling. Their estimate for 1999 was $230 billion of total insider selling or just under $20 billion monthly, up from $150 billion in 1998 and $100 billion in 1997.

Trading Float Shrunk Between 1995 And Mid-1999

Liquidity TrimTabs.com also found that prior to mid-1999, the trading float had shrunk continuously from the end of 1994. Cash take-overs of public companies and stock buy-backs are the two methods for shrinking the float. New cash take-overs topped $230 billion in 1999, although $160 billion of those deals ($20 billion per month) were announced during the first half of 1999, which was in response to the huge market sell-off in late 1998. During the second half of last year, new cash takeovers were cut in half, averaging just $10 billion monthly. That $10 billion per month pace, or $120 billion for the year, could even be optimistic for 2000. The reason, new cash take-overs in January were less than $3 billion – the lowest monthly total since at least 1996. But to be conservative, TrimTabs.com is using $10 billion monthly for cash take-overs. Stock buy-back announcements have averaged about $180 billion each of the past three years. Assuming 90% of announced buybacks get done, that translates to $160 billion annually, or $13 billion monthly.

Ten billion dollars of cash take-overs plus $13 billion of stock buy-backs equals $23 billion of float shrink monthly. Therefore, starting in February the float could grow each month by $60 billion via new offerings and insider selling, and shrink $23 billion due to cash take-overs and stock buy-backs, for a net monthly increase of $37 billion.

Where Will The $37+ Billion Of New Cash Come From?

Where will that $37 billion monthly come from? To stop a market collapse, even if $37 billion were found, it would not take care of the normal selling done by individuals for personal reasons each and every day that the market is open. Under maximum conditions, individuals could provide perhaps $20 billion monthly and foreigners $10 billion. The Federal Reserve says that foreigners have bought monthly an average $9 billion of U.S. equities during the first nine months of 1999. Maybe they can go to $10 billion monthly this year, but remember their markets have been doing better than ours lately, plus a huge amount of new offerings are scheduled offshore as well.

Individuals can't buy much more than $20 billion of U.S. funds and directed shares each month. Why? Adjusted gross income is about $6 trillion per year. Add $15 billion monthly into U.S. equity funds, plus $2 billion into global funds that doesn't go to buying U.S. stocks and $5 billion direct – all that equals $22 billion monthly or $264 billion. That's a 4.4% of AGI, which is a lot, and probably too high in reality.

Margin Debt Is Usually The Last Source Of Cash At The End Of A Bull Run

Nobody wants to bet against this stock market. Liquidity TrimTabs.com has had many conversations over the last couple of months with seasoned market professionals, and not one really thinks this could be the end of the line. Not because they have an answer as to where the necessary new cash will come from, but simply because this market has continued to go up, defying all conventional logic except for liquidity theory. And during the past five years, fresh cash has always shown up to continue to lift the market cap higher.

Biderman agrees that this market has surprised us many times since 1995. However, the float continued to shrink each month so that the new cashflows were competing for a diminishing trading float. Perhaps there is some new source of cash that will save the day in the coming weeks as well. Insiders could decide not to sell as much, and the new offering calendar could stop at $10 billion monthly. Cash take-overs and stock buy-backs could surge but will not happen unless stock prices drop at least 10% from current levels.

The only other source of fresh cash is debt. Margin debt jumped $24 billion in November and $22 billion in December – a record two-month jump. That is the only way the $34.5 billion of new offerings sold in November could have been absorbed and allowed the market cap to still rise 3.2%. December's spike in margin debt of $22 billion means that margin debt grew by $88 billion in 1999, or 62%. The market ended in 1999 at $17.7 trillion, a gain of 27%. The last time margin debt rose that much faster than the overall market was in 1993, right before the market dropped for all of 1994.

For more information, visit their web site at http://www.trimtabs.com or call Michael Alexander at 707 874 9546. ■

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