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Testing the Waters

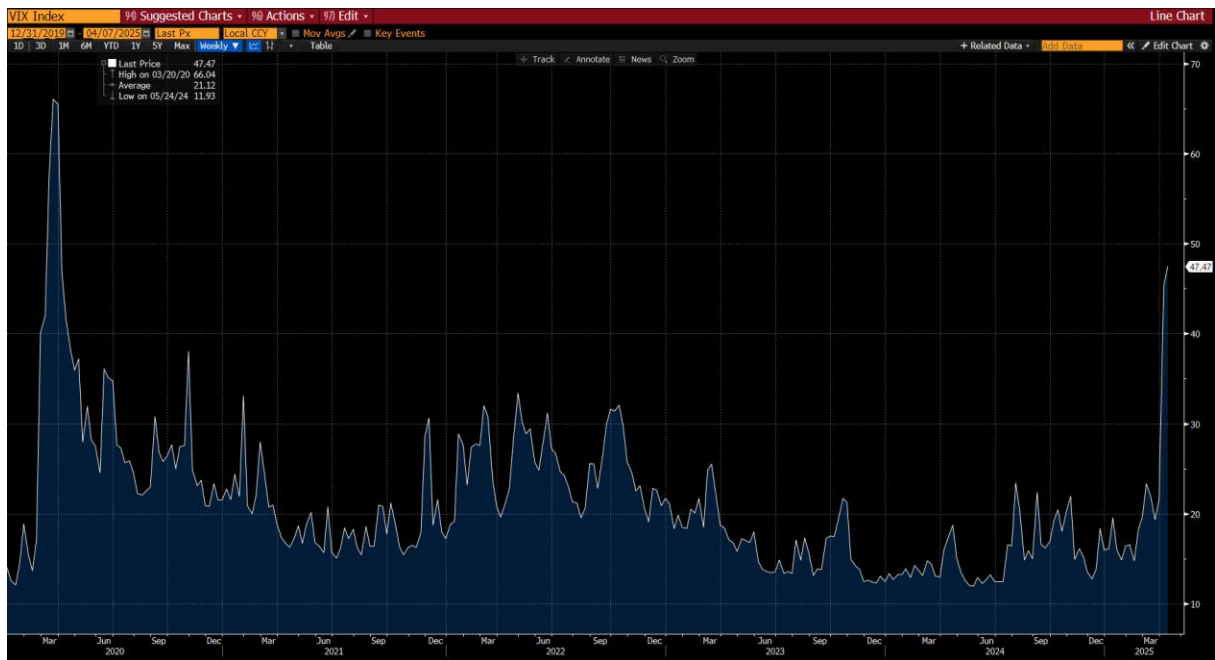
Cash Deployment: A Framework for Seizing Market Opportunities

One of the perennial challenges in portfolio management is not just holding cash, but knowing when to put it to work. Cash is an option, not an answer. In a normalized environment, holding cash comes with a visible opportunity cost. But in today's market, the flexibility to redeploy can be a critical advantage — provided we have a framework for when and how to do so.

Rather than rely on gut feel or arbitrary triggers, we lean on a triangulated approach that blends three distinct indicators: sentiment extremes, valuation multiples, and recessionary pricing. These three signals, used in combination, increase the odds of redeploying cash at points of maximum opportunity — and minimum regret.

Signs of Panic: Sentiment and Positioning Capitulation

Market bottoms are rarely polite affairs. They arrive with the unmistakable scent of panic: volatility spikes, investor surveys drenched in pessimism, and positioning data showing risk aversion at extremes. Our first signal draws from indicators like the VIX, which in panic moments functions less as a volatility measure and more as a barometer of fear.

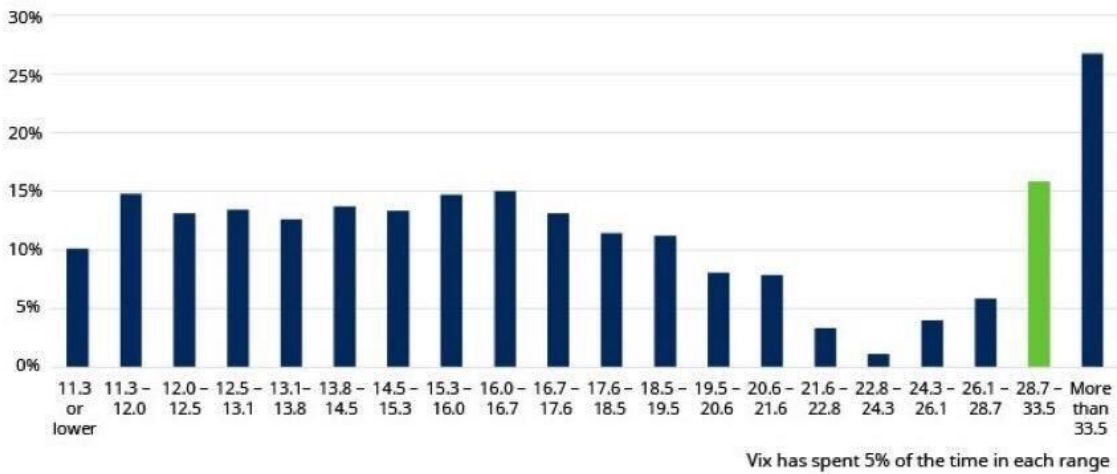


The VIX's relationship with forward returns offers a compelling illustration of contrarian signals at work. As the Schrodgers data shows, when the VIX reaches elevated levels above 28, particularly when it exceeds 33, subsequent 12-month S&P 500 returns have historically been exceptional. This pattern is intuitive: peaks in volatility often coincide with capitulation selling and maximum uncertainty.

¹ Chart provided by Bloomberg database.

Markets have performed well when the Vix has been around the current level of 30, or higher

Next 12-month return for S&P 500, based on different starting Vix levels

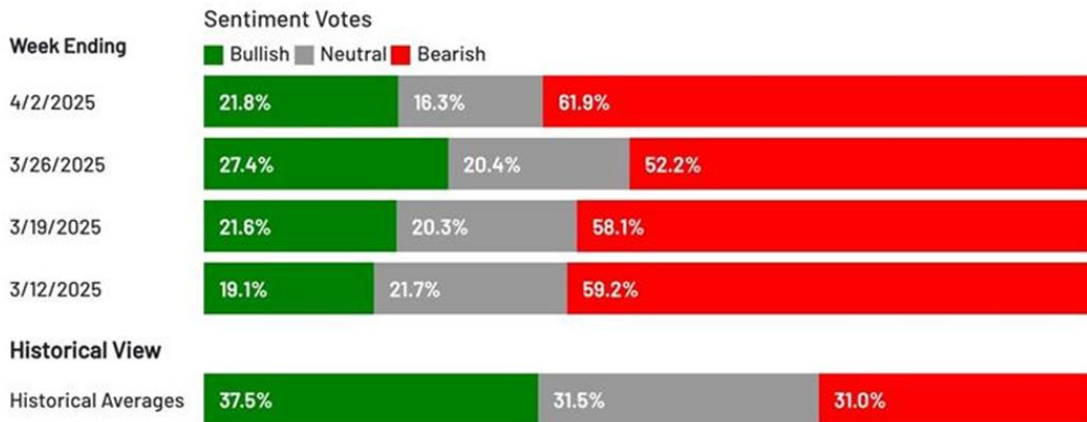


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What's notable here isn't just the magnitude of returns following high-VIX periods but the consistency of the relationship. The data demonstrates a generally inverse correlation between volatility and future performance across the spectrum. When markets price in calm (VIX below 15), forward returns tend toward the average. But when fear dominates pricing (VIX above 28), the potential opportunity set expands significantly.

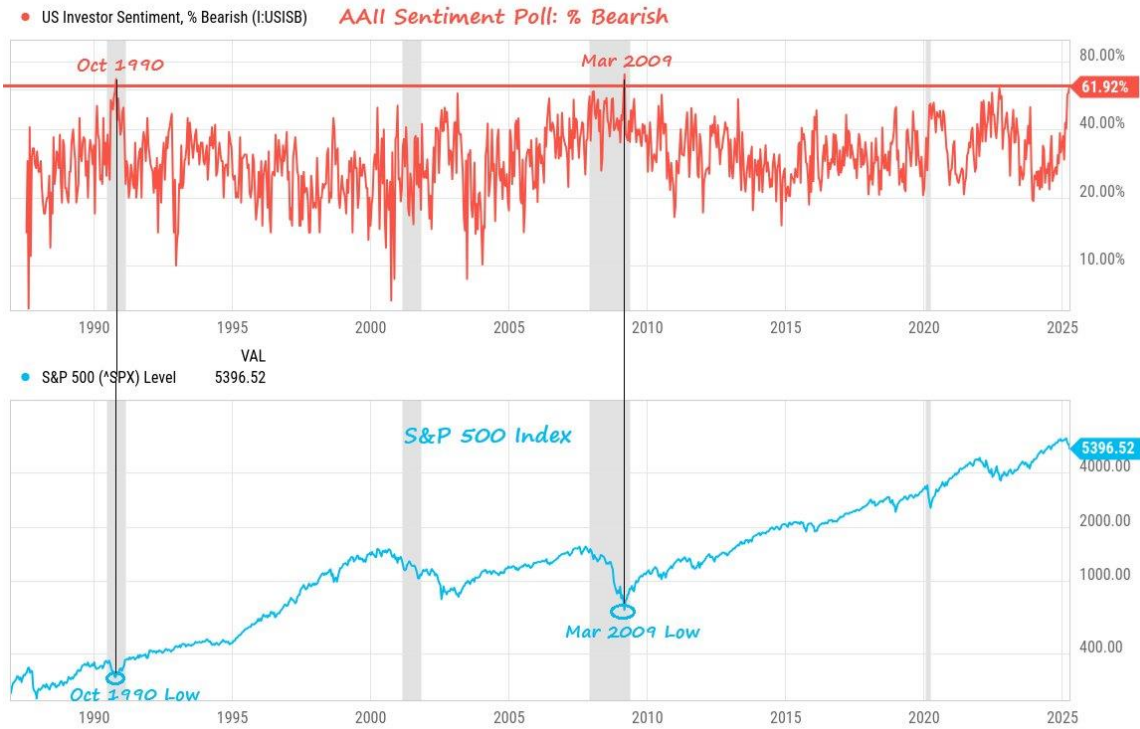
Complementing this, the AAll investor sentiment surveys tend to spike in bearishness well after market declines have taken hold. Similarly, fund manager positioning surveys reveal when professionals have already de-risked aggressively. The goal is simple: wait for signs that panic has done its work. If fear is a finite resource, these indicators help tell us when the market has exhausted its supply.

What Direction Do AAll Members Feel The Stock Market Will Be In The Next 6 Months?



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² Chart provided by Schroders
³ Chart provided by AAll

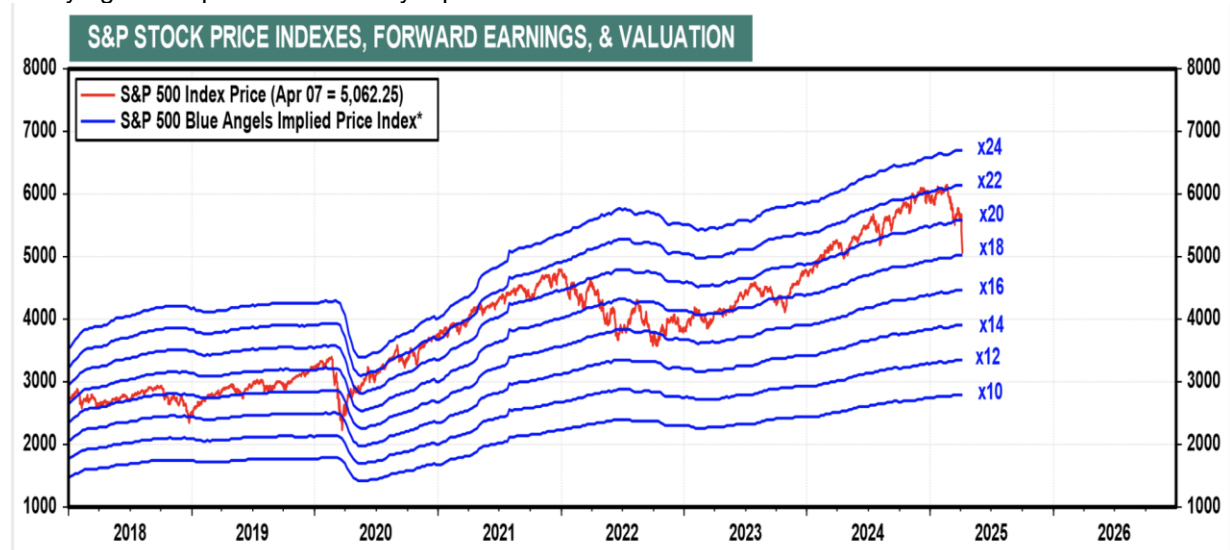


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Discounted Multiples vs. Long-Run Averages

While sentiment tells us about flow, valuation tells us about price. Our second indicator examines prevailing Forward P/E multiples against their long-term averages. In the current environment, we're watching for the moment when prices detach from fundamentals and multiples compress below historical norms.

This isn't about calling the bottom tick; it's about recognizing when the market stops pricing in optimism of any kind. By anchoring to long-term valuation histories, we gain context for whether the current selloff has meaningfully reset expectations. Importantly, this indicator works best alongside sentiment — cheap can always get cheaper if fear hasn't yet peaked.



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⁴ Chart provided by Creative Planning, YCharts
⁵ Chart provided by Yardeni Research

The chart above reveals a crucial insight: the market typically finds equilibrium at mid-teen multiples during periods of uncertainty. These levels represent the discount at which investors have historically re-engaged after significant risk repricing.

Recessionary Trough Multiples

Our final indicator is the most severe: are markets pricing in not just multiple contraction but actual earnings deterioration consistent with recession? Not every selloff coincides with recession, but when both valuation compression and earnings contraction converge, we reach the zone of maximum opportunity.

		Current '25 ESP Est (+9% y/y)	EPS y/y 5%	EPS y/y -5%	EPS y/y -10%
		269	259	234	222
<i>Multiple on 2/19/25</i>	22	5918	5698	5148	4884
<i>5 Year avg</i>	20	5380	5180	4680	4440
<i>10 Year Avg</i>	18	4842	4662	4212	3996
<i>2022 Low</i>	15	4035	3885	3510	3330
<i>2018 Low</i>	14	3766	3626	3276	3108

This earnings sensitivity matrix illustrates the point. At January's 22x multiple, even a recessionary earnings scenario of \$220 would imply only a 13% downside from current levels. Yet historical averages suggest more substantial adjustments. At historical recession-level multiples (16-18x), this same earnings deterioration would drive 29-37% drawdowns.

With S&P 500 EPS growth estimates already reduced from +15% to +9% for the full year, we must question whether consensus estimates remain too optimistic for a true recessionary scenario. When markets eventually price both multiple compression and earnings deterioration (the red zones), we find the sweet spot for deploying cash.

Conclusion

No single indicator works in isolation. But when these three converge in today's market — volatility spiking alongside extreme bearish sentiment, multiples compressing well below long-term averages, and prices reflecting genuine earnings deterioration — the balance of probabilities shifts decisively in favor of action. This disciplined approach to cash deployment is structured, historically grounded, and designed specifically for navigating the current environment. As always, the hard part isn't knowing the signals. It's trusting them in real time.

⁶ Data provided by Bloomberg database.

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