"At the end of his email blitz, which had loaded me up on data, Dougie sent me this summary: At the root of my concern is that the Bull Market in Complacency has been stimulated by:

- *the excess liquidity provided by the world's central bankers,*
- *serving up a virtuous cycle of fund inflows into ever more popular ETFs (passive investors) that buy not when stocks are cheap but when inflows are readily*

flowing,

- *the dominance of risk parity and volatility trending, who worship at the altar of price momentum brought on by those ETFs (and are also agnostic to "value," balance sheets," income statements),*
- *the reduced role of active investors like hedge funds - the slack is picked up by ETFs and Quant strategies,*
- *creating an almost systemic "buy on the dip" mentality and conditioning.*
- *When coupled with precarious positioning by speculators and market participants:*
- *who have profited from shorting volatility and have gotten so one-sided (by shorting VIX and VXX futures) that any quick market sell off will likely be exacerbated, much like portfolio insurance's role in a previous large drawdown,*
- *which in turn will force leveraged risk parity portfolios to de-risk (and reducing the chance of fast turn back up in the markets),*
- *and could lead to an end of the virtuous cycle - if ETFs start to sell, who is left to buy?"•*

- John Maudlin

The Bull Market in Complacency

The absence of market volatility and the rising probability that a flash crash may occur -- a theme I steadfastly have endorsed in my Diary -- were important elements of this weekend's news flow. Indeed, these three articles are variations on the same theme:

- John Mauldin, "The World Turned Upside Down"
- Barron's, "Black Monday 2.0, The Next Machine-Driven Meltdown" (Ben Levisohn)
- Barron's, "The Trouble With Those Can't-Miss Trades"•(Randall Forsyth)

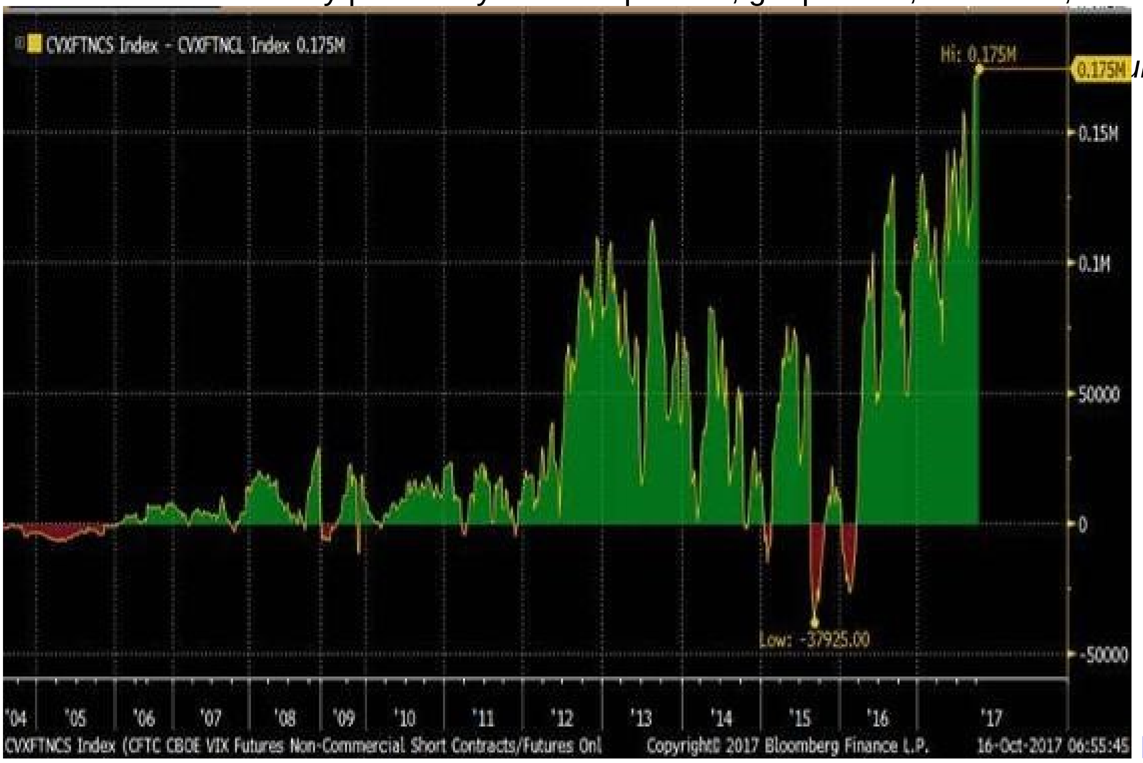
For those who are of the view that potentially adverse market outcomes are unlikely when Barron's or others like myself bring up the concerns, **I have a message for you:** A small group of us vehemently expressed deep concerns over the risks of portfolio insurance in the summer of 1987 *(which preceded a 21% market decline in October)* and, more significantly, the possible contagion of packaging financial weapons of mass destruction *(mortgage derivatives)* in the summer of 2007 *(which preceded The Great Recession of 2008-09).*

Those threats were confidently ignored in 1987 and 2007 by the bullish cabal. After all, many had said, computers really can't harm markets (1987) and home prices never can retreat (2007).

Indeed, back then, market skeptics (like myself, Barry Ritholtz, Dr. Robert Shiller, Gary Shilling and•Todd Harrison) were often laughed at publicly; they were called Cassandras, and worse. **Memories are short, and with the S&P 500 much higher many of these non-critical talking heads who dismissed the concerns of 30 years ago and 10 years ago are back self-confidently ushering in a new paradigm of uninterrupted economic growth with few accompanying market risks.**

In A Flat, Networked and Interconnected World...

The only certainty is the lack of certainty, and the one thing I am certain of is that never in history have we faced so many potentially adverse political, geopolitical, economic, social and market



...ures for the

Low-probability events do happen. **And risk is underpriced, perhaps materially so, in our interconnected world.**