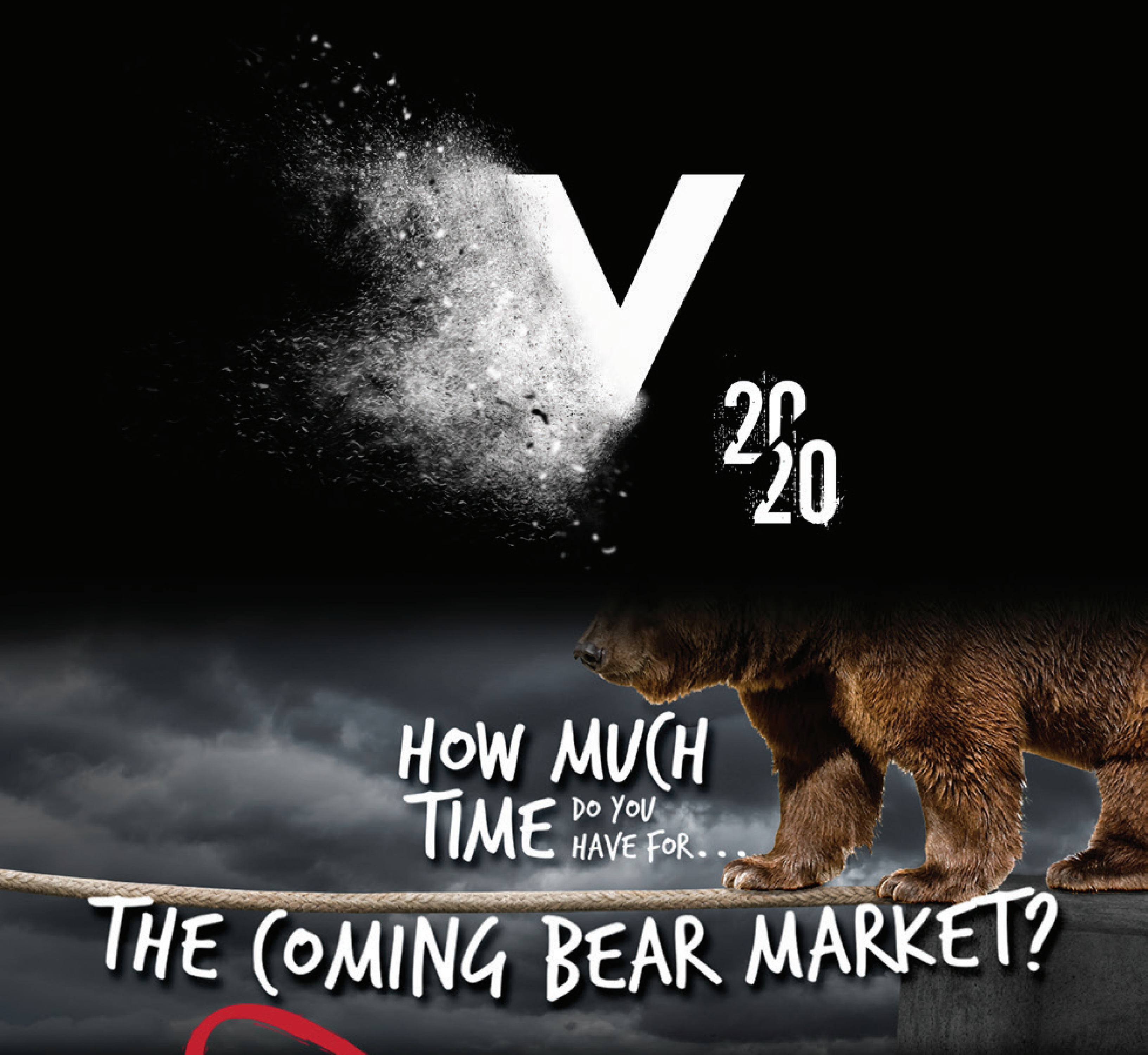


A catastrophic bear market is coming.

Either you're preparing for it... or you're astonishingly optimistic.

ONE MINUTE

With stocks making all-time highs despite worsening fundamentals, the world's markets are speeding toward a dangerous cliff.

We want to jolt you into thinking about this very seriously.

Real Vision has pulled together an elite group of successful money managers to analyze this issue in a mind-blowing new film called **Edge of the Cliff**. Each of these investors have world class track records and, worryingly, they all agree that the markets are approaching a period of significant wealth destruction.

It is important stuff.

But to be frank… we feel a little uneasy writing about it. We don't want to be sucked into the murky world of investment newsletters that exploit inexperienced investors with scary crash predictions.

Nor is this "bear porn."

Actually, this goes back to our roots. We created Real Vision after the carnage of 2008. Our goal was to avoid a repeat of that tragic situation. Not the crash itself – but the fact that so many people had no idea it was coming. Out of that mess was born Real Vision's mission to give people access to the very best information from the very best investors.

Investors such as the legendary Jim Rogers, co-creator of the Quantum fund and all-time great time investor. Jim pulled no punches when he told us that the next bear market will be the "worst of our lifetime."

5 MINUTES

According to Rogers, two key factors will ensure that the next bear market will be written about in history books.

One, there's a staggering amount of leverage in the global financial system. "In 2008," he points out, "we had a pretty bad bear market because of too much debt. The debt is much, much higher now."

Today, total U.S. public debt to GDP stands at a staggering 104%. Before the 2008 financial crisis, the highest it got was 63%.

Two, central banks have warped financial markets.

Rogers explained: "The underlying reality of the stock market is based on artificial money printing. It's not real." He's referring to the trillions upon trillions of currency units created by central banks since 2008.

Another of our dream team investors, Jesse Felder, author of the acclaimed Felder Report, agrees. Armed with stacks of data, Felder points out a disturbing – but largely unknown – characteristic of today's markets:

"This is the most pervasive overvaluation in equity markets we've ever seen in history… by far. The cheapest decile in the market is the most expensive it's ever been."

"Pervasive" is the key word here.

Felder continued: "When you average the FAANGs (Facebook, Amazon, Apple, Netflix, and Google) you get a Price-to-Earnings ratio of well over 100… And it's not just the FAANGs. It's every sector, every segment and every company. Everything is off the charts. I don't think we've ever seen anything like this…"

So how bad could this become?

Let's get some context…

U.S. markets have crashed twice this century.

The dot-com crash erased 78% of the value of the Nasdaq from early 2000 to late 2002. Many technology investors were wiped out. But outside the tech sector, losses were manageable. The Dow only fell 23% during that same period, including dividends.

The 2008 crisis was worse all-around, with the S&P 500 plunging about 55%. Even so, some sectors held up pretty well. The consumer staples ETF XLP, for example, lost only 31% peak-to-trough. Not pleasant. But survivable. U.S. Government bonds also were an effective hedge in 2008.

According to the Real Vision contributors in Edge of the Cliff, things are different this time around. Central bankers have managed to cram newly created cash into every corner of the markets. Valuations have spiked to insane levels practically everywhere. Only gold miners, certain energy stocks, and select foreign markets could possibly qualify as cheap today.

Felder went on to explain that the Russell 2000 – which is comprised of medium and smaller public companies – has a true Price to Earnings ratio above 75. This astronomical number will stun most folks because we are used to seeing the "sanitized" PE ratios published by Wall Street. But these exclude money-losing companies from the PE calculation. In reality, roughly one-third of the companies in the Russell 2000 are unprofitable.

Currently, it's hard to find an encouraging statistic on stock market valuations. Joining Felder in Edge of the Cliff was Kyle Bass, the famed Texas hedge fund manager who inspired the author of The Big Short. Bass noted that the stock market's Enterprise Value-to-GDP – his preferred valuation metric – is near an all-time high.

Meanwhile, Mark Yusko, Head of Morgan Creek Capital, pointed out that the median price-to-book ratio of the S&P 500 also ranks among the most expensive ever. Interestingly, Mark prefers the median rather than the average because the median eliminates certain accounting gimmicks.

So where does all this leave us? The largest stocks in the U.S. are obscenely expensive. Medium and smaller stocks are obscenely expensive. Even the cheapest 10% of the market is obscenely expensive by historical standards. And we haven't even mentioned bonds, which remain near all-time highs thanks to the suppression of interest rates by central banks.

Not good.

But let's not confuse inevitable with imminent. Markets can levitate at absurd valuations for years before any consequences show up. While more than a dozen experts expressed serious warnings in Edge of the Cliff, not one attempted to "call the top."

Instead, the discussion was much more nuanced. Kyle Bass, for example, referred to the wild popularity of passive investing (which we explored in last week's edition of 20/20 and which was the focus of a dramatic five-part series on Real Vision last month). Bass felt that this could be the needle that pricks the bubble. He commented: "The shift from active to passive means that risk is in the hands of people that don't know how to take risk. Therefore, we are likely to have a 1987 air pocket."

He continued: "We think a 4 or 5% decline in equities immediately becomes a 10 or 15% decline.... if you see the equity markets crack four or five points, buckle up."

Bass went on to compare the current stampede into passive investing to the "portfolio insurance" craze of the mid-1980s. Portfolio insurance was billed as a surefire way for investors to sidestep a market decline. Instead, its widespread usage largely caused the crash of '87. 23% of the value of the S&P 500 vanished in the single worst day in U.S. stock market history.

Another possible trigger, Bass surmised, is the drying up of global liquidity. In September, the Fed announced that it will finally begin selling off the trillions of dollars in assets it has accumulated since 2008. Other global central banks are following the Fed's lead. Bass explained: "The G4 Central Banks are going from a period of accommodation to a period of tightening, net of bond issuance. It's important to think about them going from half a trillion dollars of accommodation in 2016 to a trillion dollars of a draw, or more, in 2018 depending on how the ECB tapers."

Whatever is the final straw and whenever the big market correction happens, all contributors to Edge of the Cliff agreed on one thing: Investors should be shifting to a cautious stance. As Mark Yusko put it, "It's time to look at the option value of things like cash and moving higher in the capital structure in fixed income and credit."

Jesse Felder offered more specific advice. He noted that today's environment is very similar to the one that produced 400% gains in gold in the mid-2000s. Gold, one of the few financial assets that's not surging to all-time highs, remains 33% below its 2011 peak. Given that it has historically preserved wealth when the people in charge of the money supply act recklessly, it seems prudent to make gold a part of your asset allocation. Gold mining stocks might also be worth a look. After being decimated by 80% from 2011–2016, they've perked up recently.

Wrapping up perhaps the most ominous comment in Edge of the Cliff was from economist Diego Parrilla. He warned: "There are similarities between what's happening today and what led to the Lehman Crisis. In fact, I would call that Lehman 1.0 and what is developing now I would call Lehman Squared."

His urgency was echoed by several other contributors, including Econometrics specialist Mehul Saya: "It's not whether we have a financial crisis. It is a matter of choosing the name for the next financial crisis."

At Real Vision, we're quite partial to calling it "The Everything Bubble," a phrase we first heard spoken by Jesse Felder.

If you want to watch the whole of Edge of the Cliff, you can click here to start a free 7-Day trial. We have a feeling it might be worth it...

See you next week.

IF YOU ONLY LOOK AT ONE CHART

The Warren Buffett indicator points to one of the most expensive markets on record.

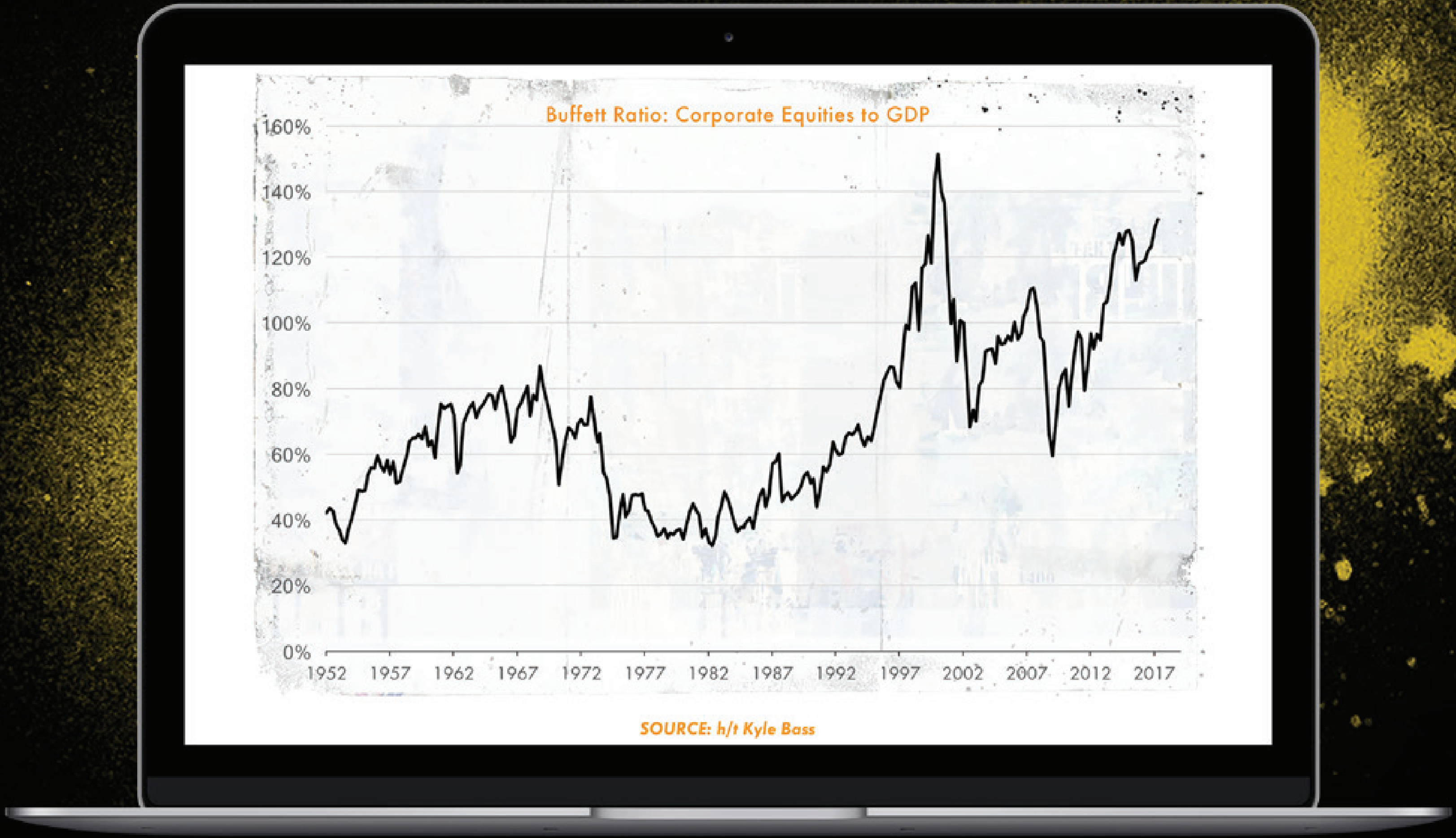
More than 100% equity to GDP has been a warning signal for an impending correction in the past.

This 8-year bull market has driven markets to rich valuations...

...yet central banks suggest no letting up in terms of stimulus.

Normal?

Find out more with the Edge of the Cliff Chart Pack. Download here.



6 DEGREES OF CONNECTION

1 SLEEPWALKING TO NEW HIGHS

We're witnessing history. Never before have U.S. markets been calmer than in 2017. Earlier this summer, the VIX, a popular measure of market volatility, sunk to an all-time low of 8.84.

Virtually every record for market tranquility has been broken this year. From 1990 to 2016, the VIX closed below 10 for a grand total of 7 times. This year alone, it has closed below 10 an incredible 25 times. Further, 12 of the VIX's 15 lowest closes in history have occurred in 2017.

Short periods of tranquility – or some might call it complacency – are nothing new in markets. But months on end of record-breaking quietness? That was completely unheard of before 2017.

CASHING IN ON CRASHING VOLATILITY 2

Many traders have flipped the decline in volatility into big profits. Just look at the story of a former manager at Target who made the news for making over $11 million shorting vol. He plans to start a short vol hedge fund...

The VIX itself is not tradable; it's merely a statistic based on S&P 500 options prices. But never fear: ETF providers have gladly stepped up to make it easy to bet on volatility. According to Goldman Sachs, there are now more than 40 exchange traded products whose prices move based on the VIX.

Thanks in part to these ETFs, shorting vol has been one of the most consistently profitable trades on the planet. Massive sums of money have flowed into these products, creating a self-reinforcing cycle. Every time vol spikes, traders pour money into short-vol products, which knocks vol down even further.

3 ETFs GET ACTIVE

The interest in volatility-linked products extends far beyond the VIX. A slew of low-vol equity ETFs now exist, and they've been gaining popularity and market share. Ostensibly, these offer equity-like returns, minus the pesky higher volatility inherent to equities. The never-ending quest for a free lunch continues.

One of the most popular is Invesco PowerShares low vol ETF (SPLV), which invests in the 100 least volatile stocks in the S&P 500. It owns many blue-chippers you'd expect in a low vol fund – Johnson & Johnson, Coca-Cola, AT&T.

But what you might not expect is that technology stocks comprise more than 11% of the fund.

4 THE CURIOUS CASE OF LOW VOL TECH STOCKS

It is curious that technology stocks would claim an 11% share of a low-vol ETF. Volatility is a hallmark of tech stocks, being that they're prone to periods of over-optimism followed by painful contractions. Tech stocks are not typically categorized with mature, stable businesses like Johnson & Johnson.

Some suggest that this has something to do with the short-vol craze. The S&P 500 is heavy on tech stocks, with FAAMNG (Facebook, Amazon, Apple, Microsoft, Netflix, Google) accounting for six of the top ten components. Recall that the VIX is based on the options prices of S&P 500 stocks.

Perhaps the interplay between the tech-heavy S&P index and the relentless shorting of volatility – via products based on options prices of stocks within that very index – is suppressing tech stock volatility? It's a mind-bender, but something to think about.

MEANWHILE THE FAAMNG GANG CONTINUE TO CHARGE AHEAD 5

Speaking of FAAMNG, pull up a chart for any of these six companies and you'll see the textbook definition of a high-flying stock. All are within percentage points of their all-time highs. The worst performer among them, Microsoft, is up a healthy 22% in 2017.

These surging giants have accounted for a huge chunk of the market's gains in 2017. For proof, look no further than the Dow Jones Internet ETF (FDN). The FAAMNG stocks comprise of a full one-third of its holdings, and it has surged an incredible 31% this year, dwarfing the S&P 500's still-respectable gain of 14%.

6 BRACING FOR A REVERSAL

With the market, led by FAAMNG, marching to new highs, it may be smart to plan your exit for when this trend eventually ends. Many believe that the self-reinforcing nature of the "vol down / stocks up" cycle will get thrown into reverse once volatility is reintroduced. And with the market being massively short volatility, we could see a short-squeeze for the ages.

We'll leave you with something to think about.

XIV, the largest of the inverse volatility ETFs, has a "kill switch" written into its prospectus. If it loses 80% of its value in a single day – which is entirely possible – the managers can liquidate the fund.

Which means this thing could literally go "poof" in a day. The tens of thousands of traders making money on the short-vol trade would be largely wiped out. Think that'd be enough to throw the short-vol trend into reverse?

NOW LIVE!

KEEPING YOU CONNECTED WITH A 360 VIEW OF ALL THE HAPPENINGS ON REAL VISION.

FROM TELEVISION TO NEWSLETTERS, INVESTMENT RESEARCH TO PODCAST– OUR FREE 360 VISION BLOG WILL GIVE YOU INSIGHT INTO THE INVESTMENT TOPICS DISCUSSED BY OUR HANDPICKED CONTRIBUTORS.

THE SNIPPET

"FACEBOOK (WITH 18,800 EMPLOYEES) HAS A MARKET VALUE GREATER THAN MSCI INDIA (POPULATION OF 1.2BN)."

-BANK OF AMERICA

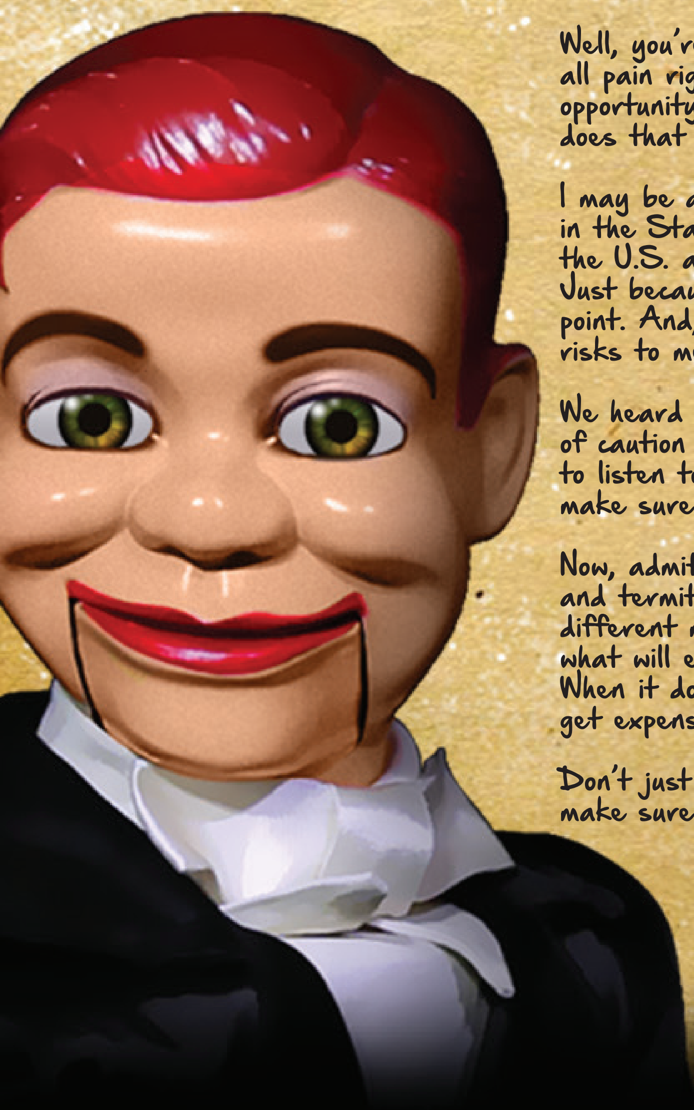
Ask Milton

question

Milton,

Markets seem to be full of confidence and, in the face of hurricanes, earthquakes, nuclear war threats and violent protests in Spain, they keep climbing relentlessly higher. What will it take to shake these markets (if anything)?

answer



Well, you're right – markets are seemingly impervious to any and all pain right now and that has been reinforced at every possible opportunity. But, let me turn the question around and ask you this: does that feel like it makes any sense to you?

I may be a wooden dummy, but even I can see that something is rotten in the State of Denmark (not to mention the rest of Europe, parts of the U.S. and don't even get me started on equity and bond markets). Just because something isn't going down doesn't mean it won't at some point. And, once you accept that, the question changes to "what are the risks to me of believing that these particular trees grow to the sky?"

We heard a who's who of Real Vision guests this week all offering words of caution in our Edge of the Cliff piece and, for my money, I'm inclined to listen to them and make a thorough assessment of my own portfolio to make sure I don't own anything I wish I didn't.

Now, admittedly, my portfolio consists mainly of furniture polish companies and termite extermination businesses, but you will probably have a little different mix. My advice? Well, I agree with those experts. I have no idea what will eventually shake these markets, but I know that something will. When it does, if you don't have a plan for how to deal with that, it could get expensive in a hurry.

Don't just sit there like a dummy – take a look at your portfolio and make sure you have a good reason to hold everything that's in it.

Milton

5xW + 1H

What's hot on Real Vision this week...

WHO

Trading psychologist and performance guru Denise Shull.

WHAT

An illuminating discussion about the role emotions play in trading.

WHERE

New York City.

WHEN

Last week on Real Vision.

WHY

It's widely believed that traders must suppress their emotions to be successful. Shull says this is false.

HOW

Instead of suppressing emotions, Shull advises her clients to strive to understand their emotions. For a trader, mental optimization comes when you learn to distinguish harmful emotions from useful ones.

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