Markets

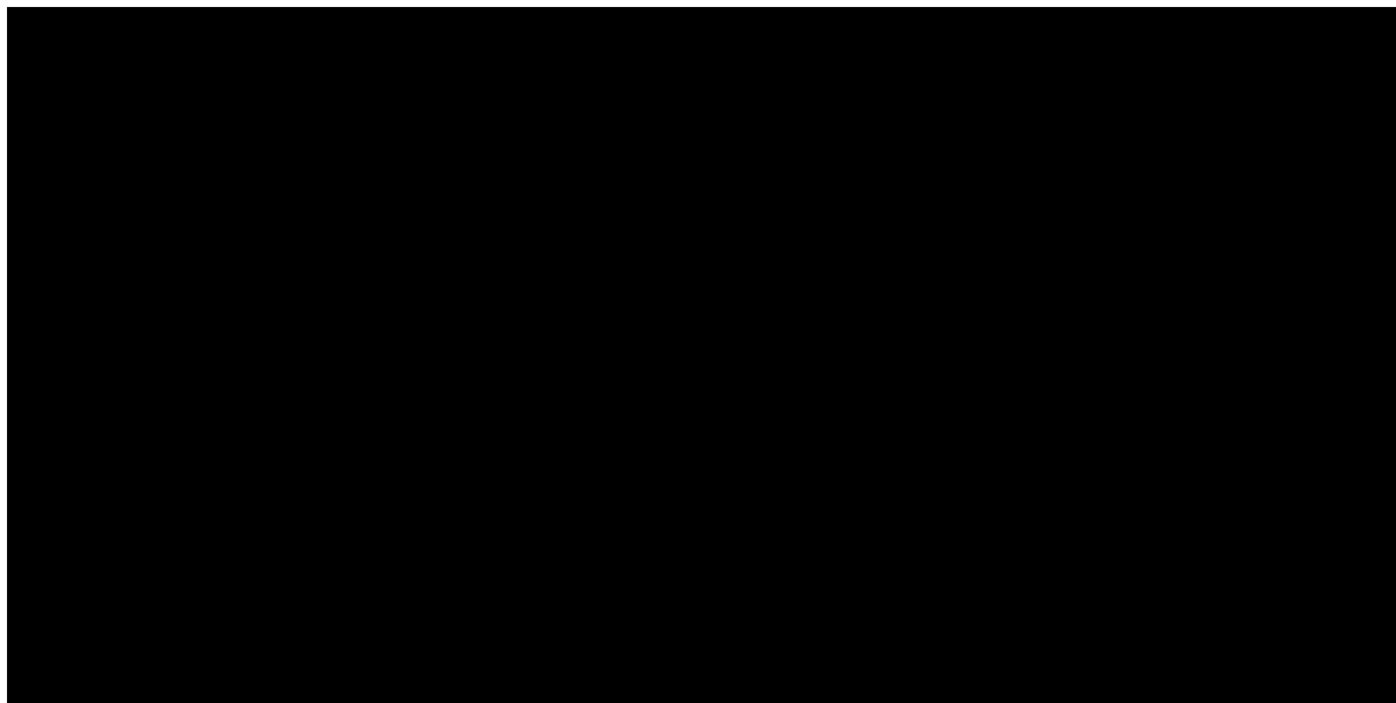
Goldman Sachs Joins Citigroup in Flashing Warnings on S&P 500

By Lu Wang

5 сентября 2018 г., 15:09 GMT+3

Updated on 5 сентября 2018 г., 23:14 GMT+3

- Citi's sentiment model signals a higher chance of stock losses
- Wall Street's voices of concern over stocks getting louder



Algebris Says EM Risks Not Over, Especially for Bonds

When investor optimism over U.S. stocks is on the rise, so are Wall Street warnings.

Sentiment has climbed to levels that foreshadowed the year's worst rout, prompting Citigroup to caution that another pullback may be in the offing. At Goldman Sachs, elevated valuations and a tightening labor market have driven the firm's bull/bear market indicator to alarming highs.

It doesn't mean the bull market will end soon. But after a 9 1/2-year rally where the S&P 500 rose 19 percent annually, investors should be prepared for lower returns in coming years, according to Goldman Sachs strategists led by Peter Oppenheimer. The firm's bull/bear market indicator has shown a close relationship with the S&P 500's forward returns since 1955, with peak

readings coinciding with the start of the last two bear markets. Right now, it’s “flashing red”, said the strategists.

The warnings mark a turnaround from last month, when persistent stock gains prompted at least two strategists to raise their year-end forecasts for the S&P 500. The index fell 0.3 percent to 2,888.60 at 4 p.m. in New York.

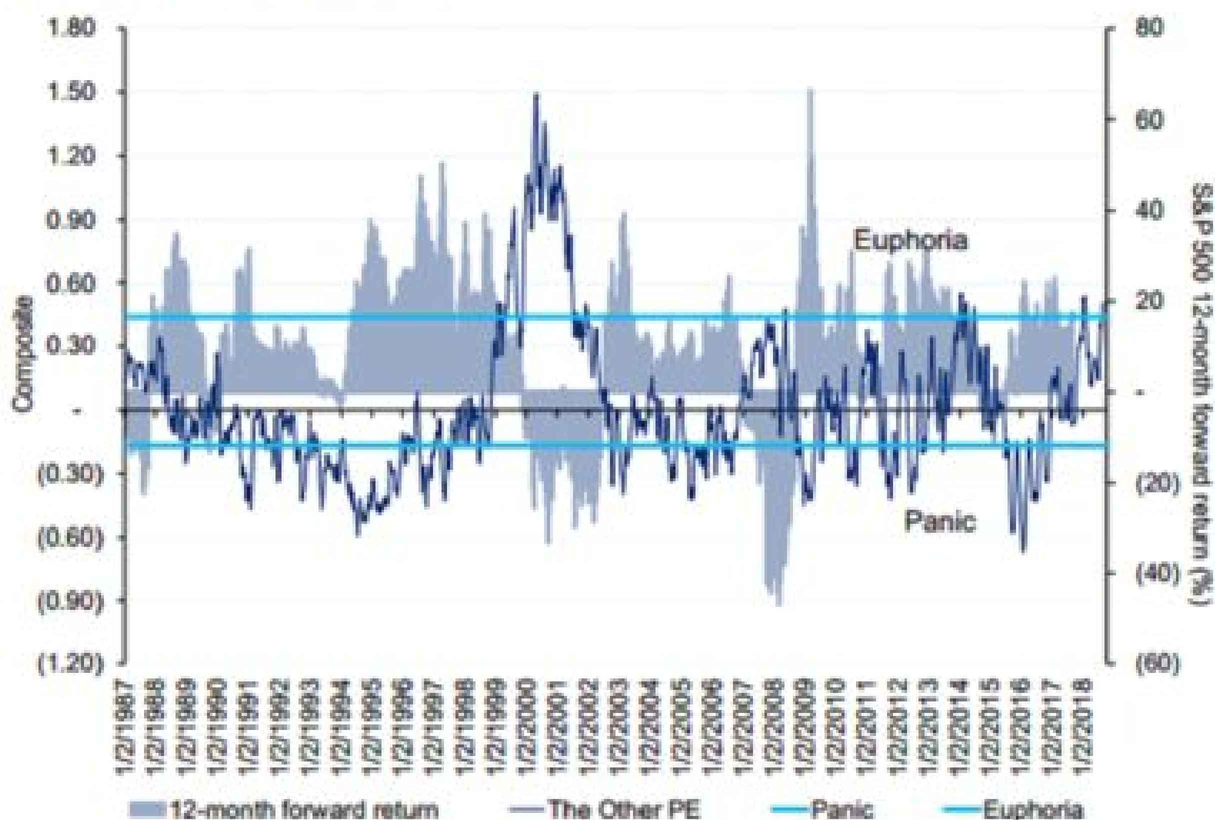
“Typically, high valuations - or an extended level of this index - imply the risk of a bear market or a period of low returns over the next five years,” the strategists wrote in a note late Tuesday. “This time we think that lower returns are more likely than an impending sharp bear market.”

The fastest economic expansion in four years, two consecutive quarters of 24 percent earnings growth and record buybacks are fueling confidence in the bull market, which by some measures has surpassed the dot-com era’s as the longest in history. With too many bulls chasing the rally, Citigroup’s strategists led by Tobias Levkovich are urging investors to cut back risk as Friday’s labor-market report could spark a selloff, just it did in February.

“The potential for faster wage gains could generate another 5 percent pullback this time, as might Fed policy, geopolitics, trade sanctions, and international economic weakness,” the

strategists wrote in a note. “It is always challenging to pinpoint the catalyst, but the vulnerability now exists.”

Citi’s panic/euphoria model, tracking everything from margin debt to options trading and newsletter bullishness, just showed sentiment climbed to extreme levels for the first time since January. Such readings have preceded equity losses over the following 12 months 70 percent of the time since 1987, more than three times the random probability.



Voices of concerns are growing louder after the S&P 500 ended August with five straight months of gains, pushing the index above 2,900 for the first time. At 21 times earnings, the benchmark traded at a multiple that’s 19 percent above it’s 10-year average.

Binky Chadha, chief global strategist at Deutsche Bank, predicted a retreat of 3 to 5 percent in September, citing the month's poor seasonality and the prospects of more economic data missing expectations. Moreover, companies will likely provide little support with earnings season not starting until October and the buyback blackout period approaching, he said.

Earlier this week, Morgan Stanley strategists led by Andrew Sheets lowered their recommendation on U.S. equities, citing the S&P 500's "extreme divergence" with other risky assets from the rest of world, peaking profit growth and a slew of risk events over the next two months, including Fed meetings and U.S. midterm elections.

– With assistance by Justina Lee, Aoyon Ashraf, and William Canny

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