

### OVERVALUATION OF EQUITY MARKET

Rationale Summary: The S&P 500 is exhibiting clear signs of overvaluation based on multiple historical metrics, compounded by seasonal headwinds in August and September, and emerging weakness in key economic indicators. This combination increases the risk of a significant correction or resumption of a broader bear market trend, potentially mirroring patterns seen before past downturns. Investors should consider reducing exposure to US equities, shifting to cash, bonds, or undervalued international markets for capital preservation.

#### Overvaluation Metrics: Stretched Valuations Signal Unsustainable Prices

The US equity market, as represented by the S&P 500, is trading at levels that far exceed historical norms across a range of fundamental valuation indicators. These metrics suggest that current stock prices are not justified by underlying earnings, assets, or economic output, raising the likelihood of a mean-reversion pullback. Based on current data (as of August 2025), key indicators are flashing red:

Indicator	Current Value (2025)	Typical Overvalued Threshold	Signal
Shiller CAPE (Relative to Mean)	38.6–38.8	> historical mean (~20–25)	Overvalued
Trailing P/E (Relative to Mean)	26.8	> 20	Overvalued
Buffett Indicator (Rel. to Mean)	2.15 / 207%	> 1.5 / 150%	Severely Overvalued
Tobin's Q (Relative to Mean)	1.76	> 1.0	Overvalued
Price-to-Book (P/B) Ratio	~4.1 (S&P 500)	> 3	Overvalued
Dividend Yield	~1.4% (S&P 500)	< 2%	Overvalued
Price/Sales (P/S) Ratio	~2.7 (S&P 500)	> 2	Overvalued
Margin Debt (NYSE, billions \$)	Elevated levels	Near record highs	Overvalued/Risk
Market Cap to GDP	2.07 (or 207%)	> 1.0 (100%)	Severe Overvaluation

These elevated ratios are driven by factors such as the disproportionate influence of mega-cap tech stocks (e.g., the "Magnificent Seven"), high margin debt indicating speculative borrowing, and a disconnect from economic fundamentals. Historically, such extremes have preceded major corrections, as seen in the dot-com bubble (2000) and the 2022 downturn. The US market's outsized share of global capitalization (far exceeding its GDP contribution) further amplifies vulnerability, with passive investment flows artificially inflating prices.

“All core valuation measures are well beyond historical averages, with the market’s pricing looking disconnected from actual earnings and economic fundamentals.”

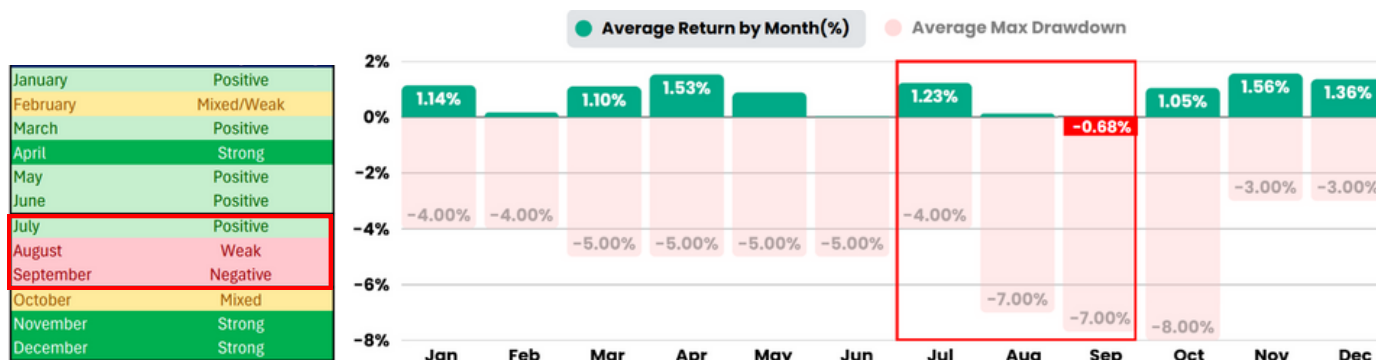
# SEASONAL WEAKNESS

## 2-month risk period

### WHY NOW?

#### Seasonal Weakness: Historical Patterns Favour Downside in Late US Summer

The S&P 500 has a well-documented seasonal tendency toward underperformance in August and September, coinciding with increased volatility, lower trading volumes, and market pullbacks. This period often sees larger-than-average drawdowns due to summer investor uncertainty, the approach of fall earnings season, and repositioning ahead of year-end. Historical data underscores this risk:



#### Average Monthly Returns: Key Trends

- **Best Months:** Historically, November, December, and April have been among the strongest months for the S&P 500, often delivering above-average returns.
- **Worst Months:** September is typically the weakest month, with average returns often negative or close to zero. August and February also tend to underperform relative to other months.

Month	Average Return (%)	% Negative Months	Average Max Drawdown	Notable Worst Months
January	1.14%	40%	-4%	-8.60% 2009
February	0.17%	43%	-4%	-11.00% 2009
March	1.10%	37%	-5%	-12.50% 2020
April	1.53%	30%	-5%	-6.10% 2002
May	0.89%	41%	-5%	-8.20% 2010
June	0.03%	49%	-5%	-8.60% 2008
July	1.23%	43%	-4%	-7.90% 2002
August	0.13%	46%	-7%	-14.69% 1998
September	-0.68%	54%	-7%	-29.69% 1931
October	1.05%	39%	-8%	-21.89% 1987
November	1.56%	33%	-3%	-11.49% 1973
December	1.36%	26%	-3%	-9.20% 2018

#### Weakening Economic Numbers: Fundamentals Point to Slowdown Risks

Recent economic data indicates a softening US economy, which could trigger a market correction as valuations compress. Despite the S&P 500's resilience, underlying indicators suggest decoupling from reality, with recession fears mounting. Common precursors to bear markets—such as those observed before the last five downturns (e.g., 2000, 2008, 2020, 2022)—are increasingly evident:

- **Economic Slowdown Signals:** Declining consumer confidence, slowing business investment, and rising unemployment rates are flashing warning signs. For instance, recent quarters have shown potential for two or more periods of declining GDP or earnings, aligning with pre-recession patterns.
- **Higher for Longer:** The Federal Reserve's efforts to combat persistent inflation have led to higher borrowing costs, tightening credit conditions, and contracting P/E multiples. Quantitative tightening and liquidity withdrawal are further amplifying selling pressure.
- **Inverted Yield Curve:** The US Treasury yield curve has been inverted (short-term rates above long-term), a reliable predictor of recessions and bear markets in nearly every instance over the past 35 years, reflecting expectations of slower future growth.
- **External and Geopolitical Risks:** Ongoing global tensions, such as energy price spikes or trade uncertainties, could catalyze downturns by exacerbating economic weaknesses.
- **Investor Sentiment Shift:** Surveys from sources like Bank of America and Bloomberg indicate a record number of professionals viewing US stocks as overvalued, with shifts toward panic selling and risk aversion.

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### WHY SHORT-TERM?

#### The world moves fast these days

In light of recent market volatility and the accelerating pace of both declines and recoveries seen over the last decade, implementing a strategic hedge is increasingly prudent. With historical data showing that bear markets can develop rapidly and recoveries may unfold just as swiftly, investors should consider a 3-month hedge to help protect portfolios from short-term downside risks while maintaining flexibility for potential rebounds. This approach is especially relevant in today's market climate, where swift and unpredictable movements are becoming the norm.

#### Last 10 Years (2015–2025)

- The bear markets and bull market recoveries seem to show sharper, quicker movements in both directions.
- The bear markets (shaded brown) after 2015 are steeper and appear to recover with shorter bounces compared to some older periods.
- The average bear market duration historically is 289 days, but recent bear markets seem shorter.
- The bull market recoveries also appear to start quickly, with rapid rises.

#### Previous 20 Years (1995–2015)

- Declines and recoveries were generally less abrupt and often more prolonged.
- For example, the 2008–2009 decline and subsequent recovery took a longer time, both down and up.
- Movements appear more drawn out, although there are still sharp moments (e.g., during dot-com crash).

HISTORICAL MARKET FALLS (last 25 years)			
Date Range	Event Description	Max Drawdown from record high (%)	Days to break even Post 2009
2015-2025	Average	-21%	127
April 2025 - August 2025	Liberation day Tariff fears	-21%	80
Jan 2022 – Oct 2022	Fed rate hikes & recession fears	-28%	219
Feb 2020 – Apr 2020	COVID-19 market crash	-34%	148
Oct 2018 – April 2018	Fed tightening & trade war sell-off	-20%	121
Jun 2015 – Feb 2016	China slowdown & global deflation fears	-16%	69
		Average Pre-2009	Average Pre-2009
Pre-2009, Markets far less volatile		-53%	1587
July 2007 – Jun 2009	GFC & credit crisis	-56%	1480
Mar 2001 – July 2002	Dot-com crash & early 2000s recession	-50%	1694

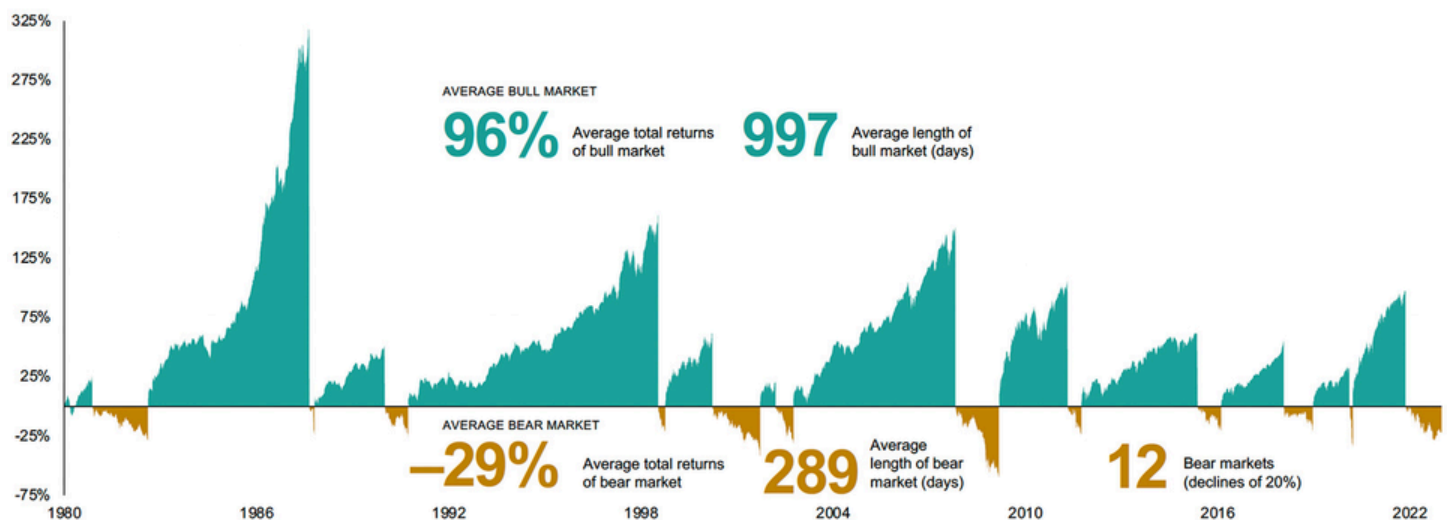
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2-month risk period

## STRATEGY

### but never fear, bull markets return quickly

Despite the occasional turbulence and short-term downturns that may prompt defensive strategies, history consistently shows that bull markets are far more prevalent than bear markets. The data highlights not only the greater frequency of bull runs but also their tendency to deliver substantially higher long-term returns. Time and again, the stock market has demonstrated remarkable resilience, finding ways to recover and generate growth even after pronounced setbacks. This persistent upward trajectory reinforces a core investing principle: staying the course and maintaining perspective through volatility can ultimately reward patient investors.



***We will look to trim some positions like BHP, FMG, DFND, WHC in the coming week on the ASX***

***Please chat with your broker about your US Holdings***

***In the event the market does fall significantly, the plan will be the same as April***

- We will start by buying the Index ETF (GEAR or LNAS)***
- Then the best value high conviction picks***

## Glossary of Financial Terms

- **Shiller CAPE (Cyclically Adjusted Price-to-Earnings ratio):** Measures stock market valuation by averaging earnings over 10 years and comparing to current prices. Used to identify long-term market overvaluation or undervaluation.
- **Trailing P/E (Price-to-Earnings Ratio):** The ratio of current stock price to earnings over the past 12 months. Indicates how much investors are willing to pay per dollar of earnings.
- **Buffett Indicator (Market Cap to GDP):** Compares the total market capitalization of US stocks to the country's gross domestic product. High values suggest overvaluation.
- **Tobin's Q:** Ratio of market value of a firm to its replacement cost. Used to assess if the overall market or specific companies are over- or undervalued.
- **Price-to-Book (P/B) Ratio:** Compares a company's market value to its book value (net asset value). Higher values suggest a premium is being paid over the company's net assets.
- **Dividend Yield:** Shows how much a company pays in dividends each year relative to its stock price. Lower yields can imply overvaluation or lower income potential.
- **Price/Sales (P/S) Ratio:** Calculates the value placed on each dollar of a company's sales. Higher ratios may indicate overvaluation.
- **Margin Debt:** Money borrowed by investors to buy stocks, collateralized by their portfolio holdings. Elevated margin debt can signal increased speculation and market fragility.
- **Market Cap to GDP:** The ratio of the aggregate value of publicly traded stocks to the nation's GDP. A measure of market valuation relative to economic output.
- **Inverted Yield Curve:** Occurs when short-term interest rates exceed long-term rates, historically signaling a recession.
- **Downside Protection:** Strategies or financial products designed to limit portfolio losses in a market decline.
- **Bear Market:** A period of falling stock prices, typically defined as a decline of 20% or more from recent highs.
- **Bull Market:** A period of rising stock prices and optimism.
- **Max Drawdown:** The maximum observed loss from a peak to trough of a portfolio before a new peak is attained.
- **Structured Investment:** Customized financial products often comprising derivatives, designed to provide specific risk/return profiles (e.g., downside protection with capped loss).
- **Leverage:** Using borrowed funds or financial instruments to increase potential returns (and risks).
- **Notional Exposure:** The total value to which an investor is exposed through derivatives or leveraged positions, differing from the actual cash invested.
- **Quantitative Tightening:** Central bank policies that reduce market liquidity by selling assets or raising interest rates.
- **Seasonal Weakness:** Periods when stock markets tend to underperform due to recurring calendar trends, e.g., August-September.
- **Recession:** A significant decline in economic activity lasting for months or years, often predated by inverted yield curves and declining indicators.
- **Upside Potential:** The likelihood or capacity for investments to increase in value.
- **Equity Market:** The market for trading ownership securities (stocks).
- **Bull Market Recovery:** The period in which markets rebound after a bear market, typically with sharp price increases.
- **Yield Curve:** A graph showing interest rates of bonds of different maturities; normal curves are upward sloping, while inverted curves can warn of recessions.
- **Passive Investment Flows:** Investment capital that moves into funds tracking benchmark indices (e.g., ETFs), often regardless of valuations.
- **Risk Aversion:** A preference for lower-risk investments, usually increasing during financial uncertainty.

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