"I'm Not Predicting, I'm Observing"

George Soros has a great line, one that I've stolen many times: "I'm not predicting. I'm observing." We really don't have a crystal ball, and it really is a dumb idea to pretend that we do. But what's not dumb is to keep your eyes and ears open, observing both what the world is telling you (playing the cards) and what other market participants are telling you (playing the players), and reacting accordingly. That's the heart of tactical investing.

What I'm observing today is that the European ***story*** is broken. I'm not saying that real world European companies are broken or that real world European economies are broken. In both cases, a few are but most aren't. What I'm saying is that the buy-Europe!™ story that has been pitched by the sell-side *ad nauseam* for the past six months is broken and that these stocks are defenseless against the steady stream of anti-Europe political news we are going to endure for the next eight weeks.

Here's the S&P 500 Index ("SPX") in white, German DAX Index ("DAX") in green, and Stoxx 600 Index in red over the past six months:

Source: Bloomberg, as of 02/26/17. For illustrative purposes only. Past performance is not indicative of how the index will perform in the future. The index reflects the reinvestment of dividends and income and does not reflect deductions for fees, expenses or taxes. The indices are unmanaged and are not available for direct investment.

Yes, the DAX has outperformed the SPX over the past six months. Why? Because every sell-side strategist and his cousin has been pounding the table that Europe is recovering and Europe is cheap and why worry about all those elections, anyway, because even if Le Pen wins it'll just be like Brexit and everything will be fine.

The truth is I don't know whether or not Le Pen will win in France this May. I don't have a crystal ball. But what I do know is that nothing is happening between now and those elections that makes it less than a

50/50 coin toss whether Le Pen wins. There's going to be a steady stream of negative press about all of the candidates from now until then, the difference being that core Le Pen supporters, like core Trump supporters, don't care about the negative press. There is no story that could make these stocks go UP, but there will be plenty of stories that can make these stocks go DOWN.

And yes, I know that for "patient, long-term investors" and all the Warren Buffett wannabes out there, what happens over the next eight weeks doesn't matter a bit, and if European stocks go down it just means that they're even more "on sale". But what I also know is that whenever I read a sell-side note talking about why something is a buy ***today*** for "patient, long-term investors", that's typically a signal to start shorting whatever they're pitching. What I also know is that it's a lot easier to be Warren Buffett when you've got $100 BILLION in more-or-less permanent capital from your insurance float. Good for him. Ain't my situation. I'm guessing it isn't yours, either.

But the risk here isn't just a temporary blip on the European horizon. Here's a picture of 2-yr French bond yields to 2-yr German bond yields (yellow), 2-yr Italian bond yields to Germany (red), and 2-yr Spanish bond yields to Germany (green) over the past six months. If you lived through the summer of 2011, this chart should give you a shiver.

Source: Bloomberg, as of 02/26/17. For illustrative purposes only. Past performance does not guarantee future results.

This is telling you that bond markets are starting to get really nervous about Europe and the stability of the Euro system, and the time frame of their nervousness is over the next two years. Could all this blow over if we get a market-friendly political result in May? Absolutely. And if that happens, maybe I'll buy Europe THEN. *But until then, I'll listen to what the bond market is telling me over whatever Goldman Sachs and Morgan Stanley and the rest of our sell-side friends is pitching me.* I'm not predicting. I'm observing.

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