

Wednesday, February 21, 2024

### DEFCON 4 for Long/Short and Aggressive Long Only Managers

With a week and a half left in February, we thought it made sense to write about what is going on with the various Types in our work compared to how we ended up 2023. Clearly, there are issues when we compare the last two years.

First of all, let's define Types for new readers. There are four Types. **Type 1** is a Short Squeeze where the stock is beating the S&P 500 and short selling is above average. A **Type 2** is Recognized Strength where the stocks beating the S&P 500 but short selling is below average. The **Type 3** is Shorts Correct where the stock is lagging the S&P 500 but short selling is above average. Last, a **Type 4** is a Long Squeeze where the stock is lagging the S&P 500 and short selling is below average.

The way we define whether short selling is above or below average is by the **Short Intensity**. This is the range of the Short Ratio over the last 5 years with a weighted rating to that period. A stock could have a Short Ratio of 2 with Short Intensity of 100% if that was the high of the range. Likewise, a stock with a Short Ratio of 8 with Short Intensity of 50% if it were in the middle of its range.

Now that we have that out of the way let's look at how many Types we have in each category. First, there are 100 stocks that are Type 1s. Meanwhile there are 251 Type 4s. In total there are 248 Stocks that a Types with a Strong Technical Rank. Meanwhile, there are 415 Types with a Weak Technical Rank.

Week Ended	Stocks Up	Stocks Flat	Stocks Down	Universe	YTD Up %
2/16/2024	2244	58	2794	5096	44.03%
12/29/2023	2575	19	2506	5100	50.49%

As you can see above only 44% of stocks are higher for the year. In 2023, 50.49% were higher at year end thanks to the November/December rally. What has been interesting to see is that even though the S&P 500 has gone to a new high for the year multiple times this year, the percentage of Type 4s has climbed as well. **This is a precursor of potential trouble ahead as the percentage of Type 4s should be falling against the S&P 500 not rising.**



In the past, as you can see above such a relationship has led a selloff or a correction in the S&P 500 when the Mkt Type 4s move above 10% after being below 10%. If the Mkt Types 4s was already above 10% then the potential for a selloff is not that great (see rectangles in the chart).

Currently, the Type 4s moved above 10% in late January and remain high at 11.21% so we are watching for a potential sell off in the S&P 500. Week by week so far this year we see some interesting data points as well. **The yellow shading** is a week where Long/Short lost more than -1% which we call a Long/Short Tsunami (Type 1s against Type 3s). **Blue shading** highlights a period where the Type 4s lost money for multiple weeks in a row. The **magenta** shading marks the low on the S&P 500 in late October.

End Date	Type 1s	Type 4s	Hedge	S&P 500	Alpha of 1s	Alpha of Hedge	Long Short Tsunami	Type 2s	Type 3s	S&P Begin	S&P End	P/L	Change	Weekly EBB
9/1/2023	5.03%	3.80%	1.23%	2.50%	2.53%	-1.27%	1.66%	4.16%	3.37%	4405.71	4515.77	110.06	2.50%	Y
9/8/2023	-2.26%	-2.96%	0.70%	-1.29%	-0.97%	1.99%	1.36%	-2.40%	-3.62%	4515.77	4457.49	-58.28	-1.29%	Y
9/15/2023	-0.30%	-0.21%	-0.09%	-0.16%	-0.14%	0.07%	-0.04%	-1.26%	-0.26%	4457.49	4450.32	-7.17	-0.16%	Y
9/22/2023	-3.98%	-3.48%	-0.50%	-2.93%	-1.05%	2.43%	1.04%	-5.21%	-5.02%	4450.32	4320.06	-130.26	-2.93%	N
9/29/2023	1.26%	-0.30%	1.56%	-0.74%	2.00%	2.30%	0.08%	0.30%	1.18%	4320.06	4288.05	-32.01	-0.74%	N
10/6/2023	-3.16%	-3.00%	-0.16%	0.48%	-3.64%	-0.64%	0.41%	-1.95%	-3.57%	4288.05	4308.50	20.45	0.48%	N
10/13/2023	0.47%	-1.48%	1.95%	0.45%	0.02%	1.50%	1.78%	0.40%	-1.31%	4308.50	4327.78	19.28	0.45%	N
10/20/2023	-1.67%	-2.12%	0.45%	-2.39%	0.72%	2.84%	4.80%	-3.11%	-6.47%	4327.78	4224.16	-103.62	-2.39%	N
10/27/2023	-2.63%	-2.60%	-0.03%	-2.54%	-0.09%	2.51%	-0.60%	-2.13%	-2.03%	4224.16	4117.37	-107.41	-2.54%	N
11/3/2023	3.28%	7.92%	-4.64%	5.85%	-2.57%	-10.49%	-6.79%	4.05%	10.07%	4117.37	4358.34	240.97	5.85%	N
11/10/2023	-1.74%	1.07%	-2.81%	1.31%	-3.05%	-4.12%	3.12%	1.56%	-4.86%	4358.34	4415.24	56.90	1.31%	N
11/17/2023	3.99%	1.35%	2.64%	2.24%	1.75%	0.40%	-2.12%	0.13%	6.11%	4415.24	4514.02	98.78	2.24%	Y
11/24/2023	1.45%	1.39%	0.06%	1.00%	0.45%	-0.94%	1.12%	1.69%	0.33%	4514.02	4559.34	45.32	1.00%	Y
12/1/2023	3.96%	3.47%	0.49%	0.77%	3.19%	-0.28%	-0.44%	0.11%	4.40%	4559.34	4594.63	35.29	0.77%	Y
12/8/2023	0.72%	-0.47%	1.19%	0.21%	0.51%	0.98%	0.56%	-1.06%	0.16%	4594.63	4604.37	9.74	0.21%	Y
12/15/2023	3.65%	4.13%	-0.48%	2.49%	1.16%	-2.97%	-1.57%	3.95%	5.22%	4604.37	4719.19	114.82	2.49%	Y
12/22/2023	4.44%	1.99%	2.45%	0.75%	3.69%	1.70%	2.55%	-1.39%	1.89%	4719.19	4754.63	35.44	0.75%	Y
12/29/2023	0.28%	1.06%	-0.78%	0.32%	-0.04%	-1.10%	0.00%	0.02%	0.28%	4754.63	4769.83	15.20	0.32%	Y
1/5/2024	-3.22%	-1.45%	-1.77%	-1.52%	-1.70%	-0.25%	-0.69%	0.02%	-2.53%	4769.83	4697.24	-72.59	-1.52%	Y
1/12/2024	-0.01%	0.14%	-0.15%	1.84%	-1.85%	-1.99%	1.35%	-2.41%	-1.36%	4697.24	4783.83	86.59	1.84%	Y
1/19/2024	-1.37%	-1.26%	-0.11%	1.17%	-2.54%	-1.28%	1.07%	-0.03%	-2.44%	4783.83	4839.81	55.98	1.17%	Y
1/26/2024	3.31%	1.96%	1.35%	1.06%	2.25%	0.29%	0.69%	1.47%	2.62%	4839.81	4890.97	51.16	1.06%	Y
2/2/2024	2.24%	-1.18%	3.42%	1.38%	0.86%	2.04%	3.89%	1.07%	-1.65%	4890.97	4958.61	67.64	1.38%	Y
2/9/2024	2.34%	0.37%	1.97%	1.37%	0.97%	0.60%	0.79%	2.32%	1.55%	4958.61	5026.61	68.00	1.37%	Y
2/16/2024	1.52%	0.51%	1.01%	-0.42%	1.94%	1.43%	-1.55%	-0.09%	1.46%	5026.61	5005.57	-21.04	-0.42%	Y

**Notice that there has not been a Long/Short Tsunami since December 15th which is now over two months. Likewise, Type 4s have not had a consecutive losing streak since late October which is now three and a half months.** Historically, there are periods of time where there is no Long/Short Tsunami Weeks or long losing streaks by the Type 4s. This is one such time.

One thing we know is that we will get Long/Short Tsunamis again and losing streaks of Type 4s. Being able to see these events develop is key to being a successful long/short manager or even just a long only manager. Right now, we are at DEFCON 4 for Long/Short and aggressive long only managers thanks to the rise of Type 4s. A move to DEFCON 3 would occur as we begin to see multiple weeks of losses in the Type 4s.

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