HedgeFolios Strategy Advisory

â??Cash Is Not Trashâ??

05-12-2025

Our Current View:

Surprisingly, China and the USA made a temporary trade agreement to pause their big tariffs over the weekend. Well, that was done in â??warp speed.â?• But this is the easy part. The hard part comes after 90 days.

US tariffs on China goods will be cut back to 30%, including the 20% Fentanyl tax, and China tariffs on US goods will go back down 10%. But again, that is only for the next 90 days while negotiators discuss optimal tariff strategies.

And on that **flimsy temporary agreement** the shorts were pushed to the wall.

Some analysts say that Trump â??blinked.â?• We say, they both blinked. This agreement really takes pressure off of Xi for the 90 days. **He was on the way of being ousted by his party**. It is like releasing a choke hold on a dangerous criminal. You may lose a great opportunity.

President Trump told reporters today that trade negotiations have led to a **â??total resetâ?•** in U.S.-China relations. He added that he may speak with President Xi **Jinping later this week**. For short sellers, that is meaningful.

Now the two countries have 90 days to see if they can agree on something substantial, and ENFORCABLE. That will be problematic.

The last agreement the US had with China was ignored by China. That trade deal was called â??Phase Oneâ?• during Trumpâ??s first term on January 15, 2020. COVID happened shortly after.

The big positive for the markets right now is psychology, which in our view is always the most important factor for the markets, aside from Fed policy.

With the big money positioned bearishly, there is lots reshuffling to be done over the very short term. Now it becomes very important for investors and traders to decide between being a very short term trader, and active trader, or a long term investor. That is the most difficult decision for everyone.

Most experienced traders know that when they are caught by surprise on the wrong side, it is wise to get out of those positions and look at the markets from the sidelines until the confusion clears. That is capital protection.

Then comes the shorter term, in this case the next 60-90 days. We believe there will be big volatility in the markets. That is where traders lose a lot of money.

The longer term active investors will assess if anything has changed for the longer term. They will probably decide that nothing has changed from where we were at the market top in mid-February, which of course was followed by a meaningful turn to the downside.

At that time, the US economy was weakening, GDP growth was going negative, China was imploding because of the bank failures, there was a huge surge in Chinaâ??s unemployment because of the collapse of their real estate market, and major European countries had clueless leadership. Since then, has much changed? The fears of that time turned to reality.

Smart investors will now think, â??do these big negatives justify paying a **record high PE of 28** for US stocks even in the best case scenario of the US and China reaching a trade agreement in 90 days?â?•

Odds are that they will come to some kind of an agreement. However, China will have the attitude that it is just a piece of paper they can ignore when they want to.

Our colleague Mish Shedlock (of MishTalk) writes:

> *Six days ago, 41 vessels were scheduled to depart China for the San Pedro Bay Complex, which encompasses both the Port of Los Angeles and Port of Long Beach in California. On Friday,* ***it was zero***

Of course, the above will change now. Ships from China will come after a few weeks and unload their goods. That will relieve some of the tensions in China. Xi Jinping will feel safer for a while. We consider this weekend agreement a win for China.

Xi Jinping uses US tariffs as an excuse for his disastrous DEPRESSION in China, which has been worsening the past 5 years, for which he is to blame. The 90 day tariff suspension relieves some pressure on him.

Therefore, what investment actions in the stock market are to be taken now depend on the age, ability, financial situation, and acumen of the individual investor. Well-financed and smart young traders who are well-versed in technical analysis can do well in such an environment. It is ideal for them.

Older, more risk averse active investors will not try to trade it and instead will prepare for what will happen over the rest of the year once the tax cuts are passed and the anticipation of the benefits kick in. We have had the view that with the current people in charge in the WH, the longer term could be very positive. We wrote about that in our **May 4 *Wellington Letter***.

It is the â??in-betweenâ?• period that will be tough for longer term oriented investors.

THE STOCK MARKET: Tech stocks, led by the â??Mag 7,â?• fueled the rally today propelling the NASDAQ Comp to a 4.4% gain while the S&P 500 closed 3.3% higher. The DJI was also strong, climbing 1160 points (+2.8%). All three large cap indices at or near their highs of the day and are all now back above their respective 200-day m.a.â??s.

Small cap stocks were also strong as the Russell 2000 bounced 3.4%. The ETF for the Russell 2000, IWM, has reached the important 50% Fibonacci retracement level (red line) of the sharp decline from

November 2024 to early April, which is often very strong resistance. However, in a strong market, that resistance is penetrated, after a potentially brief pullback.

The rally today was broad. But that could be because of the short selling over the past two months had been broad, from travel, hotels, jets, biotech, health, banks, oil, materials, among other sectors. The closing out of big shorts by hedge funds therefore contributed to todayâ??s rally.

We now have to consider **the possibility** that the bear market we had expected has already occurred. In the decline since the bull market top, the small cap Russell 2000 **plunged 30%,** the NASDAQ Comp plunged 26.8%, and the S&P 500 **plunged 21.4% peak-to-trough** (although that was on an intraday basis).

Interestingly on a closing basis the S&P 500 â??onlyâ?• fell 19.5%, just short of an â??officialâ?• bear market (i.e. down 20% or more). That suggests to us that the indices are managed and manipulated.

However, many **important large cap stocks had declines of 20%-50% or more**. Look at some of the very big cap stocks like TSLA at the low, **down 55%,** META **down 35%,** NVDA **down 43%.** Thatâ??s where we saw the bear market. It may have been the shortest bear market for stocks ever, **2-9 months depending on the stock**.

However, letâ??s consider what usually launches **a new bull market**. New bull markets donâ??t start when the majority is looking to buy and valuations are at record highs. At market bottoms, many big cap stocks are at single digit PEâ??s.

Market psychology is another important factor, as we mentioned above. We now expect **a burst of extreme optimism** that will bring a return of excessive speculation. With stock valuations currently at extreme highs, which will be exceeded on a further rally, that makes the market **very vulnerable to a sharp decline** sometime over the next 3 months.

THE CHARTS: Below is the daily chart of the NYSE COMP, a very broad index. It had a very sharp plunge in early April that looked like the start of something very bad. But then the markets rallied for various reasons, mostly for the algo traders to squeeze the shorts.

The rally has exceeded the **red resistance line** where the big â??supplyâ?• area starts. Now the NYSE is at next resistance, (short blue horizontal line). If that is exceeded on 2 consecutive closes it would suggest that the old highs will be challenged and probably exceeded. That would amplify the unusual divergences.

The QQQ is the ETF for the NASDAQ 100. Today it gapped up above the red horizontal resistance line in a powerful move. A pullback to that red line could occur soon. But it doesnâ??t have to.

THE BULLISH CASE: Today the indices all gapped up and then continued rising. That shows an urgency to get out of big short positions. This has nothing to do with how well or poor business is for these firms. Corporate fundamentals are ignored for the short term now.

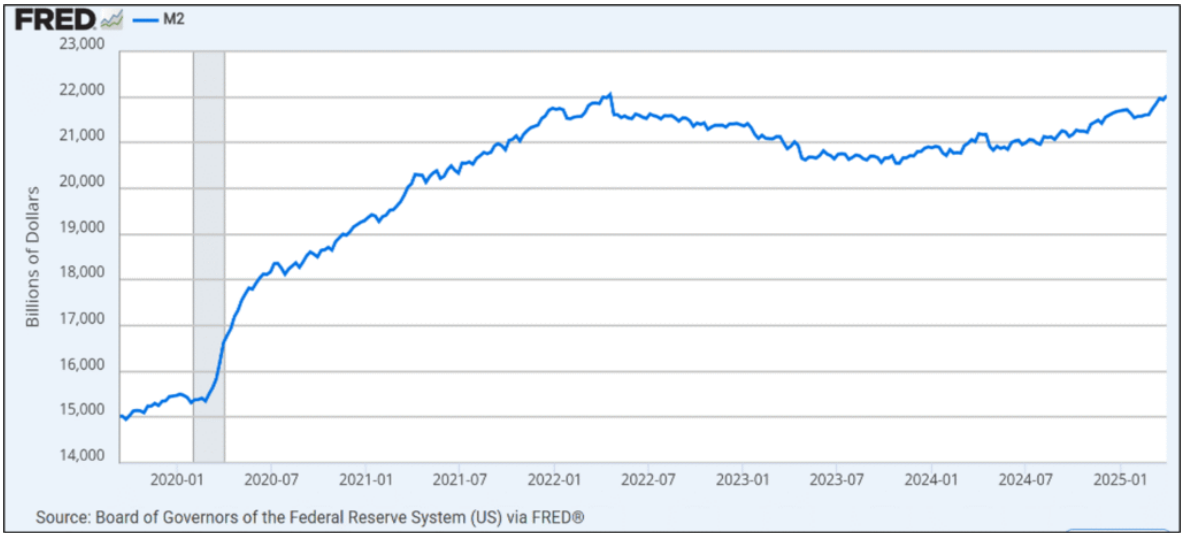
However, could there be other reasons than tariffs for the rally?

We always consider what could change our forecasts. Currently, it is not the well-known problems such as China, Ukraine, Russia, Iran, etc., although they may be used as excuse for a new bullish trend with some stock indices going to new highs.

That brings us to our 50 year old **Theory of Liquidity & Credit**. It says that the major trend of the stock market is determined by major trends in Liquidity in the markets, and the creation of new credit in the financial system. We have been writing since early this year that the money supply M2 growth **does not** suggest the Fed is tight because M2 is rising.

The Fed is possibly fueling this rally with the important rise in Money supply M2. At the start of this year, we said it would be a very volatile market, making short term T-bills an excellent investment. There are times in the market when a 4% safe return is the winner.

Here is the latest chart (to the end of March), which we showed in our May 4 ***Wellington Letter***. Rising money supply is long term bullish for stocks. In fact, we expect M2 growth to break out to a new high imminently. That has been a conundrum for our bearish case based on fundamentals. If that happens, it will cause several indices to go to new highs.



But an even more important factor that could propel stocks to make new highs in the coming weeks is the anticipated **big tax cuts promised by Trump**, especially in the **corporate tax rate to 15% from 21%.** That would make the US a **â??corporate tax havenâ?•** for the world.

Our tentative timeline for a market liftoff was originally for later this year, once the tax cuts are approved. It is always a possibility that this tentative liftoff is occurring now under the cover of the tariff suspensions. Given that there was lots of selling of stocks the prior two months, there is plenty of cash to commit.

Including the tax cuts in the bill in Congress would tell investors that Trump is serious about cutting taxes significantly. Not discussing it suggests it is being hidden until Wall Street can load up with stocks again. Perhaps that is what we are seeing now.

If the tax cuts are passed, it would give a big boost to corporate earnings and therefore, for stock prices. It would lower their PEâ??s.

You can bet that smart people in the WH are planning this. Perhaps the big smart money is acting on that.

Our HedgeFolios:

We concluded in our last Strategy Advisory (April 7) that *â??We foresee great opportunities, but this is when capital preservation is of utmost importance.â?•*

We held **over 80% in cash and cash equivalents (T-bills)** in all 5 of our HedgeFolios during the recent sharp moves, first the plunge and then the rally. That was extremely beneficial for our members who follow the model portfolios.

This is why we also said in our last Strategy Advisory that *â??reducing risk at the proper time is extremely important.â?•*

In our 3 flagship HedgeFolios (Opportunistic, Global Equity, and Income), only hold a small position in one inverse ETF. We also hold the gold miners ETF (GDX) in all 5 HedgeFolios as we expected the miners to catch up to the recent rise in gold.

Once we get confirmation of the next investable trend, we will make changes accordingly and notify our members.

Our Conclusion:

If you followed our asset allocations in our model portfolios, you are probably far ahead the best hedge fundsâ?? so far this year, at a fraction of the cost. We know that some investors questioned the wisdom of such high cash allocations ahead of the big market plunge.

It was the same ahead of the 1987 crash, when the DJI lost 22.6% in one day. We had **77% cash for several weeks ahead of that**.

Until today, the rally still had characteristics of a bear market rally. **Todayâ??s charts changed that**.

As you know, our theory has always been that one of the primary determinants of **market trends is psychology**, with fundamentals being less important. The psychology is often expressed in the charts. That is why chart patterns repeat.

Because today was caused by a quick and surprise **preliminary** agreement, a lot of the biggest hedge funds were caught on the wrong side. It doesnâ??t matter that nothing was agreed on in Geneva this weekend between the US and China.

It is like an â??armisticeâ?• agreement in war, which rarely brings peace.

But todayâ??s rally was generated by capital preservation by the big short sellers closing out their short positions. Inexperienced investors may think it is a signal for a new bull market. We will see what unfolds over the coming days and weeks and provide our analysis and HedgeFolios updates accordingly.

Wishing you successful investing,

Bert Dohmen and Dion Dohmen