

# INTRODUCING THE DOOM INDEX!





# Bill Bonner's Diary

SPECIAL REPORT

2017

## Introducing the Doom Index!

The index consists of the following data:

- Bank Loan Growth
- Corporate Bond Downgrades
- HYG Movement
- Stock Valuations (Shiller, Buffett, Tobin's Q ratios)
- Margin Debt Outstanding
- Investor Sentiment (contrary indicator)
- The Institute for Supply Management (ISM) Manufacturing Index – Raoul Pal's favorite
- U.S. Railcar Utilization
- All Employees Nonfarm Payrolls
- Household Debt to Disposable Income
- U.S. Building Permits (on a quarterly basis).

The data is tracked quarterly where possible, though we can only get annual data for a couple metrics.

[The full data sets can be seen here.](#)

When each measure gets to a certain point, it indicates danger. But just because one thing signifies danger doesn't mean the economy is about to implode...

We'd need to see many indicators flashing warning signs before the economy takes a turn.

So the Doom Index will simply reflect the total Doom Points awarded in any given quarter on the first tab of the spreadsheet. Here's the scoring system:

- 1–5: Calm waters – smooth sailing ahead.
- 6–7: The Doom Index is heating up – take caution.
- 8–9: Raise the tattered crash flag!
- 10+: Doom is upon us!

This is a fairly basic system, but you can see on the first tab that it does a good job of signaling coming danger.

The index started heating up in the second quarter of 2000 and it remained hot for the next quarter. This coincided directly with the S&P 500 topping out in August 2000.

The index then signaled it was time to raise the crash flag in Q4 2000, it and remained in dangerous territory until Q1 2002. Stocks plummeted.

The index dropped back down to a 6 in Q1 and Q2 2002. The index then flashed the "all clear" signal in Q3 2002. This coincided directly with the S&P 500 bottoming in July 2002.

The index remained calm until Q3 2006 when it started to heat up again. It then signaled the crash flag in Q3 2007. This coincided directly with stocks topping out in October 2007.

The crash flag stayed up for the next three quarters as the S&P 500 traded consistently lower.

The index then signaled Doom in Q3 2008, Q4 2008, and Q1 2009. Stocks absolutely fell off a cliff.

The index dropped down to a 7 in Q2 and Q3 2009. It then signaled “all clear” in Q4 2009. Stocks bottomed in March 2009 and traded steadily higher from there.

The index remained clear until Q3 2014 when it flashed a warning for six of the next seven quarters. It flashed clear again in Q2 and Q3 2016. It flashed caution in Q4 2016, but the Q1 2017 reading came back clear.

Credit growth is now trending down and bond downgrades are trending up. Junk bonds have not yet cracked, however.

In addition, the most recent numbers for the ISM, railcar utilization, non-farm payrolls, and building permits all came in clear for the first quarter of 2017. These numbers will need to turn south before the index heats up again.

To sum up: The Doom Index isn't going to perfectly time tops and bottoms, but it does a good job of warning us when a crash is approaching. The index would have gotten us out of the stock market before the bulk of the 2000–2001 and 2007–2008 crashes. It also would have gotten us back in once the stock market was safely trending up again.

And it is fun to be able to wave the crash flag.

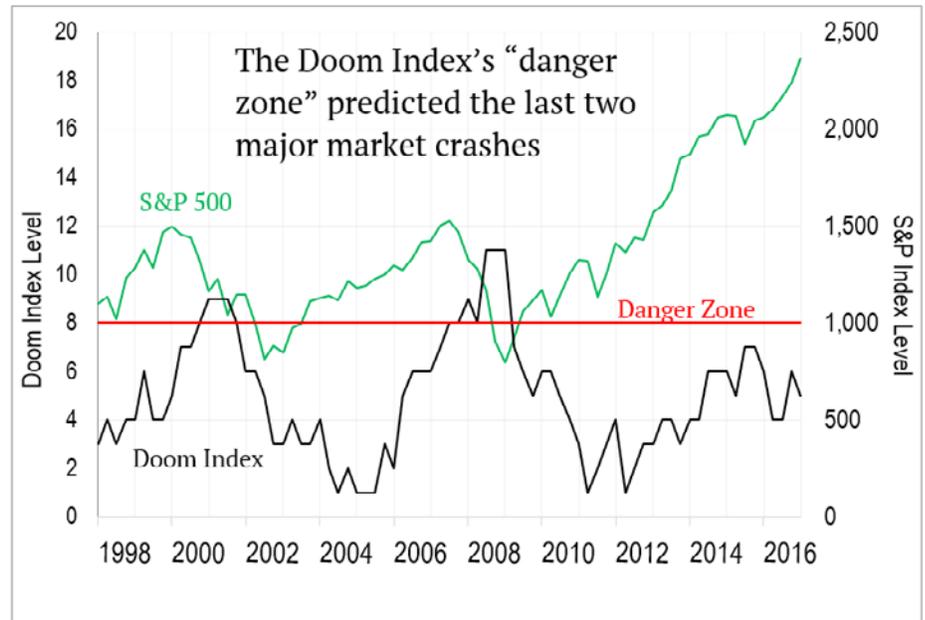
## Indicators Explained

*Bank Loan Growth* is tracked on the second tab of the spreadsheet. This data is taken directly from Federal Reserve Economic Data (FRED), and it simply tracks the growth of commercial and industrial loans in the U.S. on a quarterly basis.

Piggybacking on Richard Duncan's thesis, we are awarding one Doom Point whenever total credit growth falls below 2%. We award two Doom Points whenever credit growth goes negative.

*Corporate Bond Downgrades* are tracked on the third tab. These numbers come directly from Bloomberg. Specifically,

## The Doom Index vs. S&P 500



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Source: YCharts, Internal Calculations

we are tracking the number of bond downgrades relative to the number of upgrades in a given quarter. We are awarding one Doom Point whenever downgrades exceed upgrades.

We are tracking the *HYG* stock ticker on the fourth tab of the spreadsheet. *HYG* trades in line with junk bonds, and it is a metric to quickly gauge what is taking place in the credit markets. *HYG* also tends to be an excellent leading indicator for the stock market. We are awarding one Doom Point whenever *HYG* trades down for the quarter.

*Stock Valuations* are tracked on the fifth tab of the spreadsheet. We are following the Shiller P/E ratio, the Buffett ratio, and Tobin's Q ratio.

We award one Doom Point for the Shiller P/E ratio when it tops 24. We award one Doom Point for the Buffett ratio when it tops 100. And we award one Doom Point for the Tobin's Q ratio when it tops 1.

*Margin Debt Outstanding* is tracked on the sixth tab of the spreadsheet. We are awarding one Doom Point whenever margin debt exceeds 2%. We award two Doom Points whenever margin debt exceeds 3%. That has only happened once in the past 20 years: in 2008.

*Investor Sentiment* is tracked on the seventh tab. We view this as a contrary indicator. Stocks tend to fall when in-

vestors get too bullish. We are awarding one Doom Point whenever investor sentiment tops 45%.

*The ISM Manufacturing Index* is tracked on the eighth tab. This index monitors employment, production, inventories, new orders, and supplier deliveries based on ongoing surveys of more than 300 manufacturing firms. Naturally, the ISM is the organization that conducts these interviews.

This index is a terrific gauge of economic activity. According to Raoul Paul, a recession follows whenever the ISM Manufacturing Index falls below 46. Historical data seems to confirm this. We are awarding one Doom Point when that happens.

*U.S. Railcar Utilization* is tracked on the ninth tab of the spreadsheet. We are gauging changes in utilization on a quarterly basis. We assign one Doom Point whenever utilization falls.

*All Employees Nonfarm Payrolls* is tracked on the 10<sup>th</sup> tab. This number comes directly from the Federal Reserve. We award one Doom Point whenever wages fall. We are tracking this on a quarterly basis, but the data shows very little volatility. Wages tend to rise steadily. But when they fall, they keep falling for an extended period of time.

*Household Debt to Disposable Income (DTI)* is tracked on the 11<sup>th</sup> tab of the spreadsheet. This ratio comes directly from Bloomberg on a quarterly basis. We are awarding one Doom Point whenever household DTI exceeds 125.

*U.S. Building Permits* are tracked on the 12<sup>th</sup> tab of the spreadsheet. These numbers come directly from YCharts and are updated monthly. We are awarding one Doom Point whenever new building permit issues fall by 2% on a quarterly basis. We are awarding two Doom Points whenever new building permits fall by 7%.

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