

A Wall Street investment chief says stock market levels are 'completely unjustified' — and shares how he's positioning his portfolio in an economy that looks 'primed for recession'



Shalin Madan/Bodhi Tree Asset Management

- Shalin Madan, founder and chief investment officer of Bodhi Tree Asset Management, is getting defensive amidst a stock market levels he calls "completely unjustified."
 - In an exclusive interview with Business Insider, Madan shares how he's positioning his probabilistic, quantitative portfolio to profit.
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There are generally two schools of thought when stocks are nearing all time highs: (1) Now's the time to bet the farm and (2) now's the time to run for the hills.

[Shalin Madan](#), founder and CIO of [Bodhi Tree Asset Management](#), is firmly siding with the latter.

"This year, what you're actually finding is that you have no earnings growth in equities and very high PEs [price-to-earnings ratios]," he said in an exclusive interview with Business Insider. "An 18-times PE for a market that's not growing — and an economy that looks primed for [recession](#) — we don't think that's a very good combination."

"It's completely unjustified," he added.

For evidence of that, look no further than marketwide earnings growth. It's shrunk in 2019 while prices have remained relatively stable. Normally, you'd expect prices to contract in order to reflect the absence of earnings. But the opposite has been true — and the [S&P 500](#) is has rallied roughly 18% year-to-date.

Madan takes a probabilistic, quantitative approach to investing. He looks at the current market cycle, and tries to combine that with the macroeconomic cycle. Once he's got that dialed in, he relies on a few key indicators to help him separate a viable buy/sell signal from the noise.

Read more: [The man who wrote the book on how to make 100 times your money with a single stock outlines the core principles of his investing approach — and shares his 2 top under-the-radar picks](#)

Some of his favorites are: the ratio of copper/gold, global credit spreads, levels of volatility, and the ratio of cyclicals/defensives. These indicators help either confirm or deny potential trends and inflection points that he can use to trade.

Thanks to this strategy, when stocks plummeted in the forth-quarter of 2018, he was raking in the profits. When markets were zigging, Madan was zagging. Now he thinks a slight headwind could spell disaster for a frothy market.

"It wouldn't take much to — we think — set off what we think is a bit of capitulation trade, which is a historical precedent that marks every macro-market cycle bottom," he said. "The current environmental conditions are ripe for a Black Swan."

Today, his model is tells him the portfolio needs to be tilted towards the bearish side of the spectrum. Here's a list of positions, matched with an exchange-traded fund that can help the average investor follow suit:

- Long-duration US fixed income ([iShares 20+ Year Treasury Bond ETF](#))
- Gold ([SPDR Gold Shares](#))
- US real estate investment trusts ([SPDR Dow Jones REIT ETF](#))

In addition, Madan is short [Bitcoin](#). He views the controversial cryptocurrency as a risk appetite indicator — and it's plummeted over \$4,500 since late June, foreshadowing the move lower in equities.

"We think that it's an extremely dangerous period right now," he concluded. "It's a very fragile environment."