JOPPA MILL ADVISORS LTD.

Depth

1. the distance from the top or surface to the bottom of something.
2. the quality of being intense or extreme.

- Oxford English Dictionary

"Depth", as the term relates to the financial markets, is a metric of the quality of the markets' pricing mechanism. A market that lacks "depth" is shallow (obviously); meaning that there is limited liquidity. There is a paucity of buyers and/or sellers. A large transaction will have an undue influence on the price and any subsequent transactions. A lack of depth can be a function of a number of issues. Two of the main contributors relate to the actual number of shares in circulation (referred to as "float") and the number and appetite of the market participants. How many shares are buyers or sellers willing to transact at a given price? What is the next incremental price at which they are willing to transact? During holiday periods (think the Christmas – New Year's week or the month of August) when many Wall Street professionals are on holiday, the depth of the markets is compromised (fewer players). One of the most obvious examples is "after-hours" trading; trading after normal market hours. On the other hand, if there are a large number of buyers/sellers and their order book is substantial and orderly and reflects small price differentials for subsequent transactions, the market is said to have good depth, and therefore good liquidity. One can be confident of receiving good trade execution and the information being communicated by the price action is accurate, reliable, and meaningful.

Decent market depth is crucial for smooth, efficient markets. It tends to result in lower transaction costs and encourages participation, fostering confidence that one can enter and exit positions with relative ease. This is a fundamental tenet to facilitate efficient and effective capital markets. "Depth" is an attractive and desirable attribute.

Market participants' risk-orientation can shed some light on market depth. Uncertainty with global geo-politics or a hawkish Federal Reserve orientation can lead to what prognosticators refer to as a "risk-off" market. Buyers pull back in reaction to the plethora of panicked sellers; only willing to transact at lower and lower prices. Their bids fade. Liquidity dries up. On occasion, technical factors can influence market depth. An impending influx of Treasury issuance to finance a growing deficit can cause dealers to pull back and await higher yields before stepping in to buy.

As readers of previous issues of *Grist* know, I often draw analogies between the markets and human behavior. After all, human behavior is the ultimate arbiter of market prices. "Depth" applied to the human personality, generally refers to the alternative definition. It describes the character of the individual and evidences a value judgment on the qualities of that person's substance. Like market liquidity, a "shallow" individual tends to be concerned with issues at the surface, often without a great deal of thought or consideration and almost certainly without compassion or empathy – at least not with any sincerity. In addition to lacking in sincerity, a "shallow" individual rarely adds much value to a relationship or even a conversation, being inherently reluctant to show commitment and engagement. They do not contribute to meaning and understanding, often detracting from the context of the interaction. A lack of depth is best avoided if possible.

Extending this analogy one step further, consider "depth" in the context of your personal relationships, including your financial, legal, or spiritual advisors. Superficial interactions are not satisfying or consequential. While seeming to address whatever the situation on the surface, if you do not feel heard or appreciated, how can that relationship flourish and ultimately prove nourishing? Do these individuals sincerely have <u>your</u> best interests foremost in their thoughts and actions?

Just like dealing with a shallow person, a market (or a relationship) lacking depth is also deficient in character and meaning. It can prove dangerously deceptive. The superficial interaction does not reveal anything about what is going on below the surface….

At present, the markets appear to have good depth and therefore good liquidity. I offer this explanation as a cautionary tale. Attitudes toward risk, and therefore market depth can change abruptly. One must be attentive to such potential shifts in preferences and remain objective about the story the data is telling.

Riding the wave of anticipated interest rate cuts and the productivity potential of Artificial Intelligence, the S&P reached a new two-year high in January, and continued to grind higher through February, posting subsequent new highs through March 4th, bringing the 2024 year-to-date return to 7.1%.[i] As a slight uptick in inflationary data in January postponed the prospect of interest rate cuts, bond yields turned higher rising roughly 35 basis points to the 4.25% level, translating to a -2.0% loss on 7-10 year U.S. Treasuries and a commensurate loss of -1.75% in the Barclays U.S. Aggregate Bond Index. Communication Services and Information Technology have led the markets' rally, with Health Care equities rebounding from a dismal 2024. Despite this constructive undertone, individual equities have withstood some sharp price action, often associated with disappointing guidance for 2025 revenues and earnings. (TSLA, PANW, HUM) The predominant factor driving the equity market is Momentum; heavily psychological by nature.[ii]

Character is everything, in life and investing!

Jim

[i] First Trust *Market Minute* , March 2024
[ii] Ibid