MARKS ON THE MARKET

All-You-Can-Eat Technicals and A La Carte Fundamentals

TECHNICAL ANALYSIS:

The markets came into October on a high (and we're not talking about marijuana stocks), but quickly turned and reminded us why October has such a bad reputation for equities. If you have been following the Jeff Saut pieces we have been sending out almost daily, then you saw his prediction that the technical charts broke down in early October, indicating a near-term top was in and a correction was on the menu. The equity indexes subsequently corrected (10.5% on the Dow, 9.9% on the S&P 500, and even more for small caps) off their highs over the past 6 weeks. The technology sector has been one of the hardest hit, with 73% of tech stocks in correction territory or worse. Saut's technical prowess has even us impressed, as he day-by-day has been feeding us the market swings, leaving us dizzy and a bit nauseous. We are happy recently to see his technical charts appear to show a bottom was made as October closed.

A LA CARTE FUNDAMENTALS:

Trade Wars and Negotiations: While there is no question that tariffs are a risk (in our opinion, the greatest risk) to economic growth and corporate health, we believe a lot of this is reflected in the market now, and any positive resolutions going forward should be met with positive reactions by the market. All recent rhetoric aside, we suspect talks will accelerate over coming months, and from here, any steps (even small) in the right direction will be appreciated by the markets.

Corporate and Consumer Health: Too Good To Be True? – October's employment data, with the lowest unemployment since 1969, 250,000 new jobs blowing away expectations of 200,000, and most impactful average hourly wages growing to 3.1% year over year, was surprisingly met with market weakness. In addition, stock market performance over the past 6 weeks makes it difficult to believe that approximately 2/3 of companies surprised to the upside on 3Q 2018 earnings. It just goes to show that over the short term, the market can even go down on good news. One thought is that investors are fearful that good news will mean more or more aggressive rate hikes.

The Fed: Normalizing the Fed Funds Rate - Also in the market, we believe, is not only a December hike in rates, but 2-3 2019 rate hikes as well. We doubt the Fed will surprise with additional hikes, and feel that any stray from current fiscal tightening intention (and subsequent reduction in expected hikes) would be bullish. We also point out that after a likely December hike, we will still be well below a historical normalized rate of 3-4%, and low relative to economic growth levels (even at a slightly slower pace in 2019).

Economic Growth: Speaking of Peaking – We're reminded of the old saying, "If I had a nickel". If I had a nickel for every time in the last 6 weeks I have heard the word "PEAK"; peak earnings, peak profit growth, peak revenues, etc. The FEAR of a PEAK is that you can only go down. We argue, however, that a reduction in peak earnings can still be strong earnings, a reduction in revenue growth can still be growing revenues, and a peak in GDP can still see decent GDP growth. For example, if 2019 sees 2.5% GDP growth rather than 3%, we believe that will still be supportive to equity markets. Strong balance sheets, good consumer demand, capital goods orders trending higher, continued favorable interest rates, and tax cuts should all be bullish for U.S. companies, and in turn, our economic activity.

Midterm Election Results: A Split Congress – Over the last 80 years, the S&P 500 has gained over 11% per year when control in congress was split, regardless of the party in the white house. Since 1950, the one-year return on the S&P 500 after the last 17 midterm elections was positive in all cases, with an average gain of 15.3%.

We do believe we are again experiencing a healthy market correction, and the bottoms could already be in. These types of corrections are typical in any bull market, but particularly common in what could be the later innings of the secular bull. Still, investors, in our opinion, need to stay true to their asset allocations and convictions. We believe the secular bull is not over, and this market still has legs. We recognize it can be difficult to see portfolios decline, even temporarily….But we were reminded by Rick Santelli this morning from the Mercantile Exchange, "Markets have corrections, if you don't like that, don't trade the markets!"
There's something to chew on.

Please reach out to us anytime to discuss this or anything else.

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