WealthShield

Market Outlook | January 28th, 2019

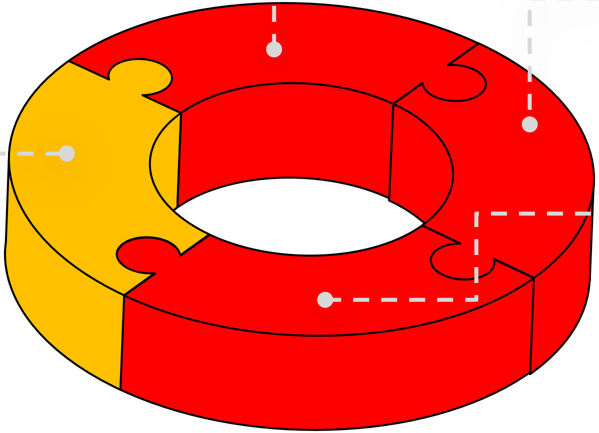
INVESTMENT FRAMEWORK

MARKET SENTIMENT

Are asset classes in positive or negative trends? How are asset classes trending relative to each other?

VALUATIONS

How expensive are assets? Where do they stand relative to historical prices?



FEDERAL RESERVE ACTIVITY

Expansionary or Restrictive?

ECONOMIC ACTIVITY

Is the economy growing or shrinking?

POLICY OR DATA?

The risk rally in equities that started December 26th, has been blamed on an array of causes. Yes, Steve Mnuchin did have an emergency meeting with the Plunge Protection Team, or Working Group on Financial Markets. Yes, the Federal Reserve did become more data dependent and reduce the number of forecasted interest rate hikes. Yes, the PBOC (Chinese Central Bank) launched a stealth QE, thereby injecting billions of dollars in liquidity.

Last week an article in the WSJ referenced the Fed considering to stop their quantitative tightening (balance sheet reduction) policy. We have seen some strategists reference this as a bullish development and a potential catalyst for further upside in stocks. We hope they are right, but this is something we saw coming when we entered a growth slowing environment. The fact that growth and inflation started to slow during the fourth quarter of last year meant that the Fed would likely halt their tightening all together and move to an easier policy stance. That is exactly what has occurred. What we find most surprising is the notion that the Fed halting rate hikes and stopping the selling of bonds will be enough to suspend stocks at valuations that register in the top decile historically.

The data is not illustrating a resurgence of economic growth yet, so we remain skeptical. Furthermore, market trends are still negative over intermediate and long-term time horizons. That being said, confidence has improved as stock prices have been going up. The law of diminishing marginal returns would indicate that if growth continues to slow, the Fed and global central banks would be required to move to extraordinary measures to reignite. The optimist in us hopes that this is not the case and that an easier stance on the margin will spur the next cyclical upturn. Unfortunately, we do not see this as the most probabilistic scenario. Therefore, the monetary policy component of our framework is neutral (yellow) and not green. The Fed would have to cut interest rates for us to view monetary policy as accommodative.

POLICY OR DATA?

Last week, the Economic data was mixed this week as existing home sales had one of the worst month over month declines on record. They dropped -6.4% over the past month. Unless there is a recession on the horizon, which we do not see in the data at this time, housing may be nearing a mid-term bottom. How robust the rebound will be is another question—one with important implications for economic growth. The Markit Flash PMI manufacturing report came in better than expected at 54.9. This showed that manufacturing activity has seen an improvement. The ECRI Weekly Leading Index rose as well, picking up to -5.2% year over year. The four week moving average of this indicator moved down to its lowest since 2012, coming in at -3.52% year over year. Despite the uptick in some of the data last week, growth is still slowing on a forward looking basis.

Next week we get a lot of economic data as we approach month end and the start to February. Home prices, pending home sales, the Fed meeting (and interest rate decision), January jobs data, and the ISM report are all released next week. We also get fourth quarter GDP on January 30th, which we expect to reflect the growth slowing data we have seen in the ECRI weekly leading index, the recent ISM report, and housing.

If growth continues to slow down in the US and international markets, we expect the Fed and global central banks to become increasingly accommodative. It is our opinion that they will have to move quickly and with heavy liquidity injections to create an environment supportive of positive economic growth and risk taking. Until then, we think the market will be disappointed with the net effect of marginal dovish posturing. We could be wrong, and would obviously respond accordingly by changing our opinion with the data. However, the data is demonstrably conclusive regarding the fact that we are in a growth slowing environment.

Within our framework the data trumps any policy response. However, we remain open to the possibility that liquidity injections could create a proclivity for risk taking. For now, the data warrants a focus on risk management.

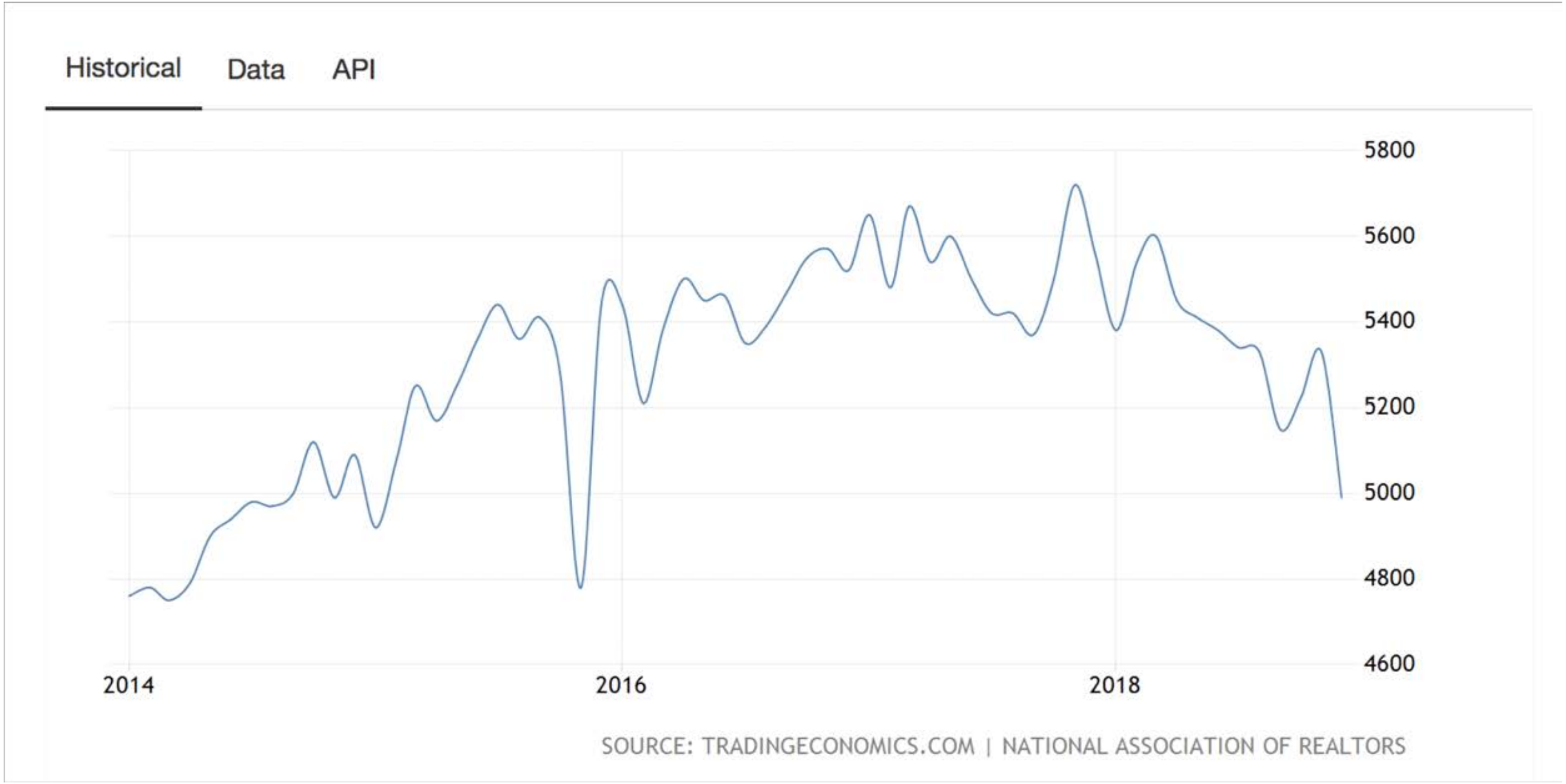


Chart 1: Existing Home Sales dropped -6.4% over December.

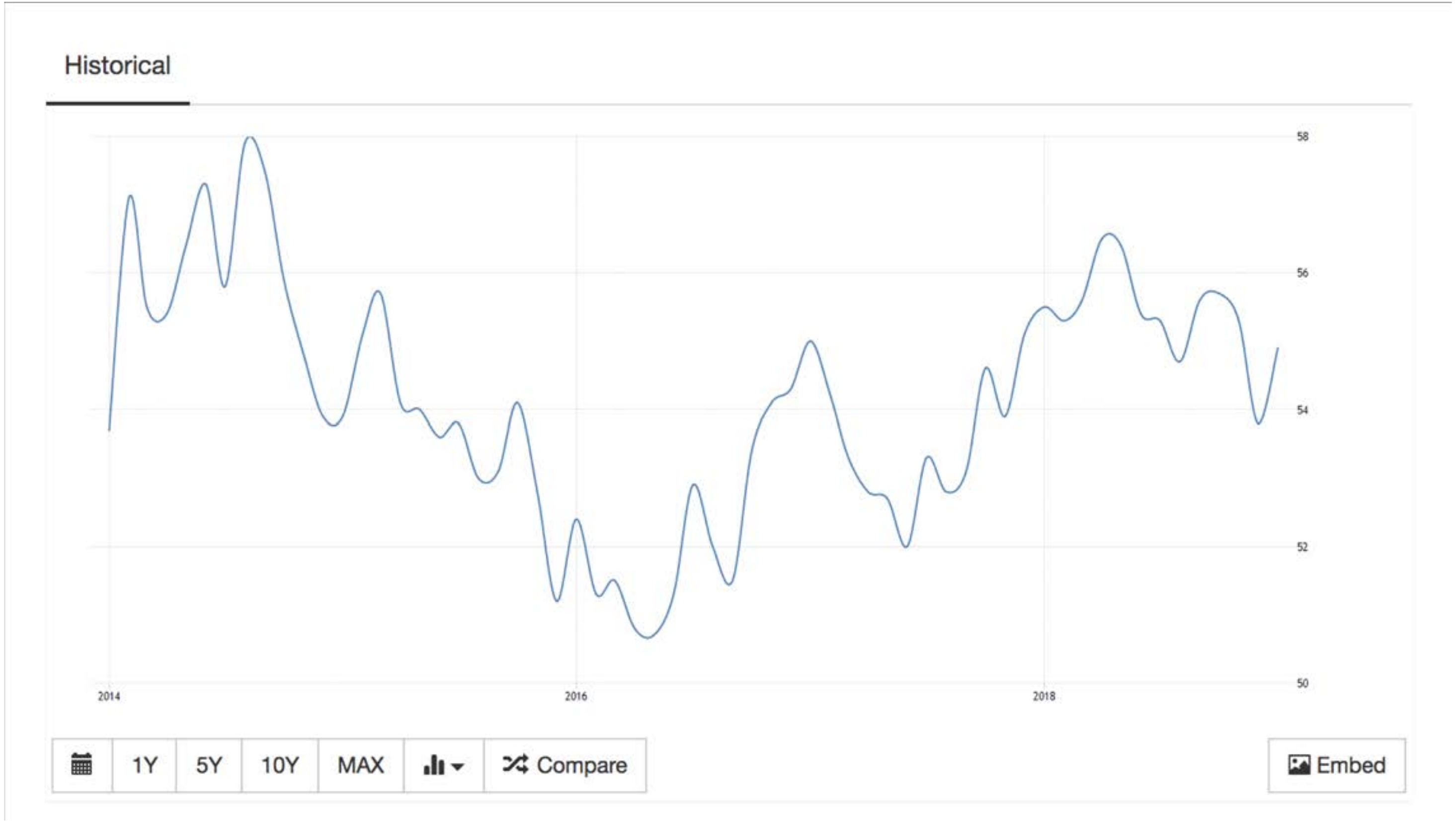


Chart 2: Markit Flash PMI Manufacturing improved to 54.9 this month. This particular indicator of manufacturing strength is making a series of lower lows and lower highs.

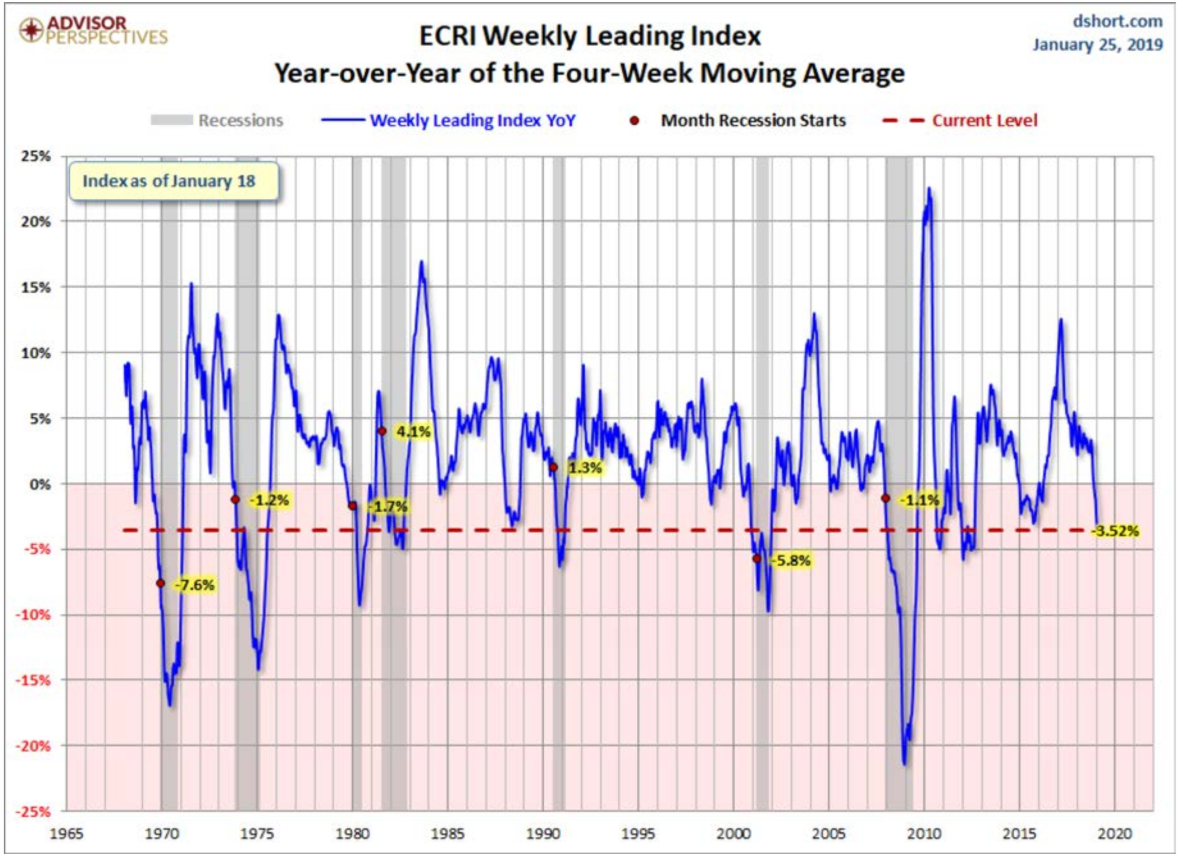


Chart 3: ECRI Weekly Leading Index. The four week moving average of the weekly leading index dropped to -3.52% year over year.

Symbol	Name	Close	Chg	% Chg	+/-	Date
$HSI	$HSI - Hang Seng	27569.19	478.38	1.77		01-25, 16:00
$MSEMF	$MSEMF - Emerging Markets	1032.34	14.34	1.41		01-25, 16:00
$CAC	$CAC - French CAC 40 Index	4925.82	49.89	1.02		01-25, 16:00
$DAX	$DAX - German DAX Composite	11281.79	76.25	0.68		01-25, 16:00
$NIKK	$NIKK - Tokyo Nikkei Average	20773.56	107.49	0.52		01-25, 16:00
$MSEAFE	$MSEAFE - MSCI EAFE	1813.63	8.53	0.47		01-25, 16:00
$MSWORLD	$MSWORLD - MSCI World ex USA	1811.97	7.99	0.44		01-25, 16:00
$SSEC	$SSEC - Shanghai Stock Exchange	2601.72	5.71	0.22		01-25, 16:00
$INDU	$INDU - Dow Jones Industrial Average	24737.20	30.85	0.12		01-25, 16:00
$NDX	$NDX - Nasdaq 100 Index	6787.37	2.76	0.04		01-25, 16:00
$RUT	$RUT - Russell 2000 Small Cap Index	1482.85	0.35	0.02		01-25, 16:00
$RUA	$RUA-Russell 3000 Index	1573.31	-2.05	-0.13		01-25, 16:00
$WLSH	$WLSH - Wilshire 5000 Composite	27580.24	-37.04	-0.13		01-25, 16:00
$SPX	$SPX - S&P 500	2664.76	-5.95	-0.22		01-25, 16:00
$TRAN	$TRAN - Dow Jones Transportation Average	9921.78	-90.28	-0.90		01-25, 16:00
$SPDAUDP	$SPDAUDP - Dividend Aristocrats	1114.57	-16.01	-1.42		01-25, 16:00
$VIX	$VIX - Volatility Index - New Methodology	17.42	-0.38	-2.13		01-25, 16:00

EQUITY MARKET RECAP

- International equities led the way closing the week up 0.44%.
- The Wilshire 5000 fell -0.13% for the week.
- Small caps were stronger than large caps last week. The Russell 2000 finished up 0.02%
- Energy was the worst performing sector, dropping -1.43% for the week.
- REITS were the best performing sector, gaining 1.44%.
- The Low Volatility factor (SPLV) gained 0.32% for the week.
- Dividend growth (Dividend Aristocrats) fell -1.42%.

Chart 4: The Hang Seng Index rallied 1.77% last week. It remains in a negative long-term trend.

Chart 5: Wilshire 5000 fell -0.13% last week and remains in a negative long-term trend.

Chart 6: MSCI All World Ex-US rose 0.44% last week. It is still in a negative long-term trend despite the recent strength.

FIXED INCOME RECAP

Symbol	Name	Close	Chg	% Chg	+/-	Date
$UST2Y	$UST2Y - 2 year yield	2.60	-0.02	-0.76		01-25, 16:00
$UST3M	$UST3M - 3 month yield	2.39	-0.02	-0.83		01-25, 16:00
$UST30Y	$UST30Y - 30 year yield	3.06	-0.03	-0.97		01-25, 16:00
$UST20Y	$UST20Y - 20 year yield	2.92	-0.03	-1.02		01-25, 16:00
$UST10Y	$UST10Y - 10 year yield	2.76	-0.03	-1.08		01-25, 16:00
$UST5Y	$UST5Y - 5 year yield	2.59	-0.03	-1.15		01-25, 16:00
$YC3MO	$YC3MO - 3mo - 10yr yield curve	0.37	-0.01	-2.63		01-25, 16:00
$YC2YR	$YC2YR - 2-10 yield curve	0.16	-0.01	-5.88		01-25, 16:00

- The 2-10 year yield curve finished the week at 0.16%, down from the previous week.
- The 3mo-10 year Treasury yield curve closed the week at 0.37%, also down from the previous week.
- The benchmark 10 year Treasury bond yield dropped 3 basis points for the week and finished at 2.76%.
- Long-term Treasury bonds finished the week up 0.38%.

Chart 7: Long-Term Treasury Bonds rallied 0.38% last week. They are in a positive long-term trend.

CURRENCY MARKET RECAP

Symbol	Name	Close	Chg	% Chg	+/-	Date
$GBPUSD	$GBPUSD - British Pound to US Dollar (NBD)	1.32	0.03	2.58		01-25, 16:00
$EURUSD	$EURUSD - Euro to US Dollar (NBD)	1.14	0.00	0.41		01-25, 16:00
$CADUSD	$CADUSD - Canadian Dollar to US Dollar (NBD)	0.76	0.00	0.40		01-25, 16:00
$JPYUSD	$JPYUSD - Weekly Solid Line, 1280	0.91	0.00	0.22		01-25, 16:00
$EURJPY	$EURJPY - Euro to Japanese Yen (NBD)	124.93	0.25	0.20		01-25, 16:00
$AUDJPY	$AUDJPY - Australian Dollar to Japanese Yen (NBD)	78.60	-0.07	-0.09		01-25, 16:00
$USDJPY	$USDJPY - US Dollar to Japanese Yen (EOD)	109.47	-0.24	-0.22		01-25, 16:00
$JPYEUR	$JPYEUR - Weekly Solid Line, 1280	0.80	-0.00	-0.25		01-25, 16:00
$USD	$USD - US Dollar Index - Cash Settle (EOD)	95.47	-0.53	-0.55		01-25, 16:00
$NYXBT	$NYXBT - Daily Solid Line, 1280	3552.10	-53.82	-1.49		01-25, 16:00

- The British Pound gained the most against the US dollar, rising 2.58% from the week prior.
- The Euro also gained 0.41% against the US dollar.
- The dollar fell -0.55% on a trade weighted basis.
- The dollar weakness helped contribute to the rally in emerging and international equities markets.
- Bitcoin fell -1.49% last week against the dollar, closing at 3552.10.

Chart 8: The US Dollar fell -0.55% last week against a trade-weighted basket of currencies. The trend remains positive.

COMMODITIES

Symbol	Name	Close	Chg	% Chg
$LUMBER	$LUMBER - Weekly Solid Line, 1280	381.50	26.60	7.50
$PLAT	$PLAT - Weekly Solid Line, 1280	818.30	16.20	2.02
$SILVER	$SILVER - Weekly Solid Line, 1280	15.70	0.30	1.95
$GOLD	$GOLD - Gold - Continuous Contract (EOD)	1298.10	15.50	1.21
$SOYB	$SOYB - Weekly Solid Line, 1280	925.25	8.50	0.93
$WHEAT	$WHEAT - Weekly Solid Line, 1280	520.00	2.25	0.43
$COPPER	$COPPER - Copper - Continuous Contract (EOD)	2.73	0.01	0.37
$COTTON	$COTTON - Weekly Solid Line, 1280	74.13	0.24	0.32
$CORN	$CORN - Weekly Solid Line, 1280	380.25	-1.50	-0.39
$WTIC	$WTIC - Crude oil	53.69	-0.35	-0.65
$CRB	$CRB - Reuters/Jefferies CRB Index	180.68	-1.54	-0.84
$PALL	$PALL - Weekly Solid Line, 1280	1319.80	-15.30	-1.15
$BRENT	$BRENT - Weekly Solid Line, 1280	61.64	-1.06	-1.69
$SUGAR	$SUGAR - Weekly Solid Line, 1280	0.12	-0.01	-4.53

- Lumber broke out last week, closing up 7.50% for the week.
- Precious metals were strong last week as well.
- Sugar was weak, finishing down -4.53%.
- Brent oil was down-1.69% for the week.
- The Reuters/Jefferies CRB Index was down -0.84% for the week.

Chart 9: Lumber broke above previous highs and rallied 7.50% for the week. The next logical resistance is at the 40 week average.

Chart 10: Gold climbed 1.21% last week and remains in a long-term positive trend.

MARKET RELATIONSHIPS

Symbol	Name	Close	Chg	% Chg
$LUMBER:$GOLD	$LUMBER:$GOLD - New Favorite	0.29	0.02	6.21
$MSEMF:$MSEAFE	$MSEMF:$MSEAFE - New Favorite	0.57	0.01	0.93
SPLV:SPY	SPLV:SPY - New Favorite	0.18	0.00	0.57
SPHB:SPLV	SPHB:SPLV - Weekly Solid Line, 1280	0.82	0.00	0.49
$EJK:$EJN	$EJK:$EJN - Weekly Solid Line, 1280	1.68	0.01	0.40
VIG:SPY	VIG:SPY - New Favorite	0.39	0.00	0.10
$SML:$SPX	$SML:$SPX - Weekly Solid Line, 1280	0.35	0.00	0.08
MTUM:SPY	MTUM:SPY - New Favorite	0.40	-0.00	-0.19
$WLSH:$AKG	$WLSH:$AKG - New Favorite	258.83	-1.21	-0.46
HYG:IEF	HYG:IEF - New Favorite	0.81	-0.00	-0.49
$WLSH:$MSWORLD	$WLSH:$MSWORLD - New Favorite	15.22	-0.09	-0.57
$COPPER:$GOLD	$COPPER:$GOLD - New Favorite	0.00	0.00	-0.83
TIP:TLT	TIP:TLT - New Favorite	0.91	-0.01	-0.86
$SPDAUDP:$SPX	$SPDAUDP:$SPX - Weekly Solid Line, 1280	0.42	-0.01	-1.20
$WLSH:$GOLD	$WLSH:$GOLD - New Favorite	21.25	-0.29	-1.33

- Lumber rallied substantially against gold. This could be a positive sign for future economic activity and stock market returns.
- Low Volatility rallied 0.57% against the S&P 500, signaling a defensive rotation in stocks last week.
- Inflation expectations fell as Copper dropped against Gold and TIPs fell against long-term Treasuries.
- Growth rallied against value. Large Cap Growth closed the week in a positive trend against Large Cap Value.

Chart 11: Lumber rallied against Gold. A continued rally in Lumber relative to Gold could signal positive future economic surprises.

Chart 12: Copper fell against Gold last week signaling that inflation pressures continued to decelerate. This relationship has not supported the risk rally in equities. It remains in a negative trend.

Chart 13: Large Cap Growth rallied to break out to a new positive trend relative to value. This is a positive sign for risk assets.

Chart 14: The Momentum factor ETF fell against the SPY. It is still in a negative trend and rolling over. This is not encouraging.

SUMMARY & PLAYBOOK

- International equities markets rallied last week to continue the risk on move that began at the end of 2018. Global stocks remain in negative trends broadly.
- The total US market (Wilshire 5000) fell slightly despite a strong finish to the week. US stocks are still in negative trends on an intermediate and long-term basis.
- Precious metals markets were huge benefactors of stimulus injections and a weaker US dollar last week. Gold, silver, and palladium are all in positive trends. We believe that precious metals present an interesting opportunity if the Fed continues to shift more dovish.
- US Treasuries rose on the week as yields fell. We continue to recommend Treasuries as an overweight.
- Lumber had an impressive week and the Lumber versus Gold ratio is suggesting that we may have positive economic data to look forward to in the coming weeks.

Overweights:

Treasuries, Low Volatility, Defensive sectors, Dividend Growth, High Quality

Underweights:

Credit, Momentum, Cyclicals, Growth.

DISCLOSURE

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