# WealthShield

**November 19th, 2018**

# HERE COME THE DOVES…

The Vice Chairman of the Federal Reserve, Dr. Rich Clarida, formerly of Pimco, conducted an interview with CNBC where he made significant comments regarding the current Federal Reserve policy.

*"As you move in the range of policy that by some estimates is close to neutral, then with the economy doing well it's appropriate to sort of shift the emphasis toward being more data dependent,"* Clarida said during a "Squawk Box" interview, his first public comments since being confirmed in September.

It is interesting to us that the Fed is starting to discuss "data dependency" versus a continued systematic tightening approach. This is an encouraging sign since one of our worries is that the Federal Reserve might tighten into an economic environment where both growth and inflation were slowing simultaneously. This could have the potential negative effect of ushering in deflation that can take hold rapidly.

Dr. Clarida's words do not suggest that they are going to pause policy at the moment, but they are a bit more Dovish than the tone we have heard from Powell. As we featured in our article, Three Reasons Why the Fed Could Cause the Next Recession, we are worried about the potential for the Federal Reserve to overshoot their neutral rate, especially during a time period where valuations are high, market trends are negative, and economic growth is slowing. Dr. Clarida has given us some comfort that if the rate of growth and inflation in the US starts to decline, they will respond in a supportive fashion.

Whether or not this will be enough to change the market trends back to positive, we will have to wait and see. It will be interesting to see if "data dependent" language becomes more prominent in their December meeting minutes, especially since the market expects them to raise interest rates another quarter point.

# NDVA NIGHTMARE


**Chart 1: NVIDIA, the popular chip maker and market darling for the last several years, dropped 20% this week as the stock missed revenue estimates and disappointed on guidance. The stock was down almost 19 percent on Friday, opening down over 15 percent after the earnings release on Thursday. The leadership change we are witnessing, especially the weakness in semiconductor stocks, has us concerned that more volatility may be ahead of us.**

# INVESTMENT FRAMEWORK

There has been no change in our investment framework as of this week. However, we believe economic growth is close to moving red. We moved into a growth and inflation slowing quadrant in October. We are waiting on confirmation from the year over year rate of change in nominal GDP to support the slow down. We moved this indicator to yellow as we became cautious on the growth and inflation picture, based on falling inflation expectations, and the ECRI Weekly Leading Index declining year over year.

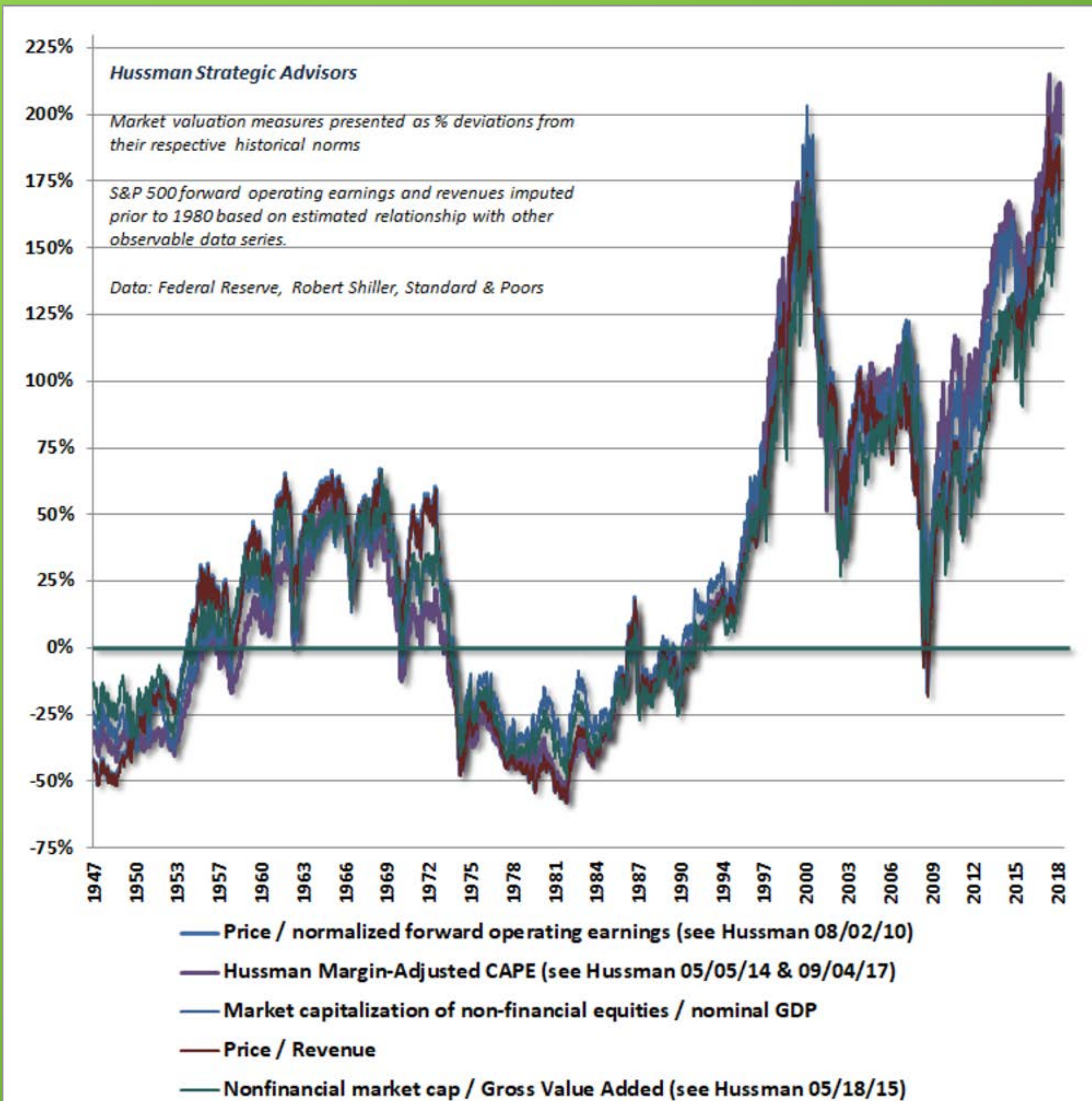


**Chart 2: Long-term valuation metrics suggest US stocks to be highly valued.**

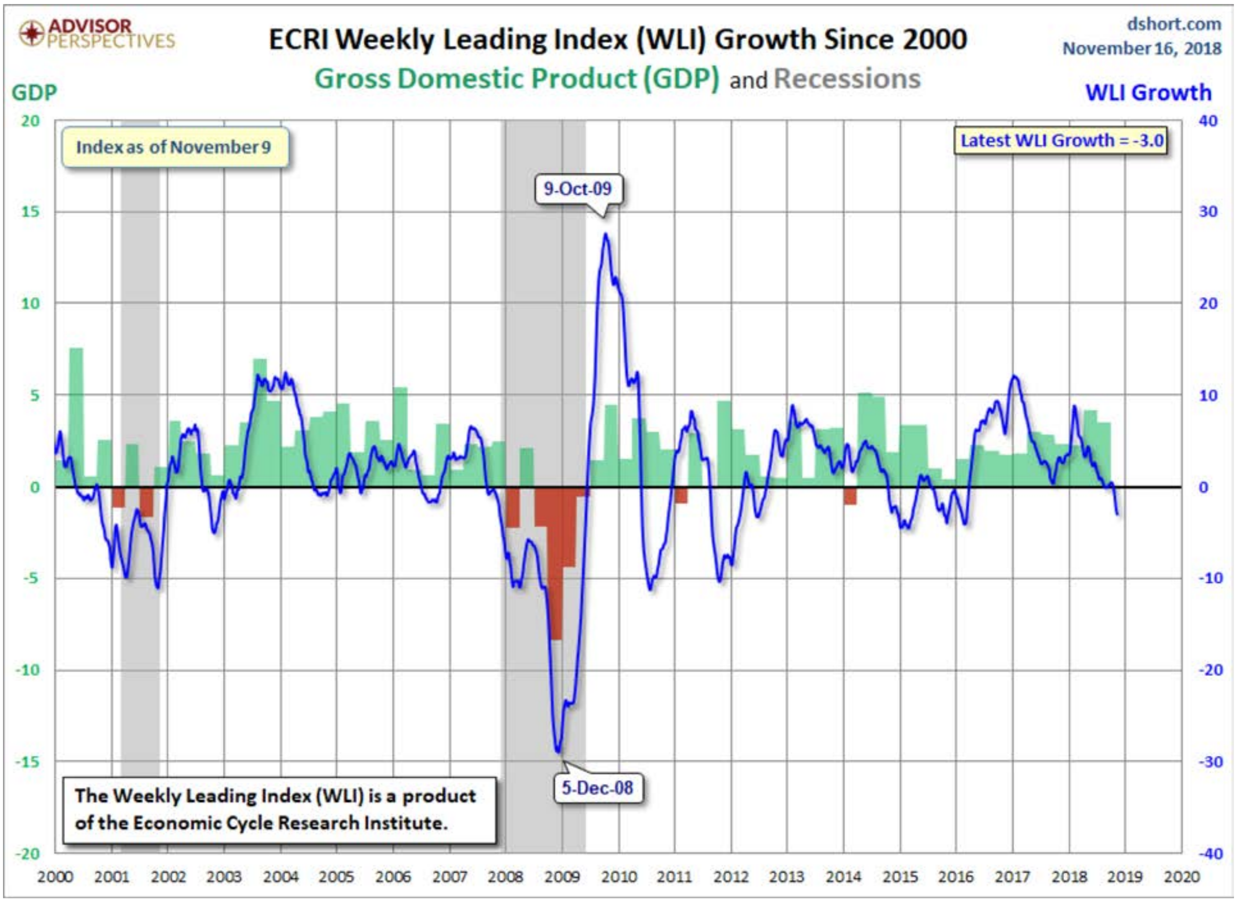


**Chart 3: ECRI Weekly Leading Index declined further to -3.0% year over year. Growth in the US is slowing.**


**Chart 4: The 10 year Treasury Bond yield minus the 2 Year Treasury Bond yield steepened this week as short-term bonds dropped more than long-term bonds. The market may be expecting further Dovish moves out of the Federal Reserve.**


**Chart 5: The Vanguard Total World Stock Market Index is in a negative trend. This index fund tracks the FTSE Global All Cap Index which is almost 8000 stocks and represents a majority of the global investable universe. We believe this index is a good barometer of overall market trends.**

# MARKET SUMMARY:

WORLD MARKET PERFORMANCE

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| S&P 500 | 2,736.27 | -44.74 | -1.61% | 2.34% |
| Dow Industrials | 25,413.22 | -576.08 | -2.22% | 2.81% |
| Nasdaq Composite | 7,247.87 | -159.03 | -2.15% | 4.99% |
| Russell Global | 2,025.75 | -32.69 | -1.59% | -5.5% |
| Russell Global EM | 3,063.86 | 12.67 | 0.42% | -15.9% |
| S&P/TSX (Canada) | 15,155.50 | -118.94 | -0.78% | -6.50% |
| Mexico IPC | 42,319.27 | -1905.95 | -4.31% | -14.18% |
| Brazil Bovespa | 88,515.25 | 2874.06 | 3.36% | 15.85% |
| Euro Stoxx 600 | 357.71 | -8.03 | -2.20% | -8.09% |
| FTSE 100 | 7,013.88 | -91.46 | -1.29% | -8.77% |
| IBEX 35 (Spain) | 9,056.80 | -78.00 | -0.85% | -9.83% |

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| Swiss Market Index | 8,907.39 | -166.64 | -1.84% | -5.06% |
| CAC 40 Index (France) | 5,025.20 | -81.55 | -1.60% | -5.41% |
| DAX Index (Germany) | 11,341.00 | -188.16 | -1.63% | -12.21% |
| Irish Overall Index | 5,983.45 | -188.68 | -3.06% | -14.99% |
| Nikkei 225 | 21,680.34 | -569.91 | -2.56% | -4.76% |
| Hang Seng Index | 26,183.53 | 581.61 | 2.27% | -12.49% |
| Shanghai Composite | 2,679.11 | 80.24 | 3.09% | -18.99% |
| Kospi Index (S. Korea) | 2,092.40 | 6.31 | 0.30% | -15.20% |
| Taiwan Taiex Index | 9,797.09 | -32.92 | -0.33% | -7.95% |
| Tel Aviv 25 Index | 1,634.82 | -22.67 | -1.37% | 8.28% |
| MOEX Index (Russia) | 2,372.67 | -30.80 | -1.28% | 12.46% |

Source: Bloomberg; Index % change is based on price.

**Table 1: Equity Market Returns as of November 16th, 2018. Courtesy of Envestnet | PMC**

Equities Markets dropped over the week in the US. The S&P 500 was down -1.61%, the Dow dropped -2.22%, and the Nasdaq fell -2.15%. The Russell Global Index was down -1.59% for the week as well. The Hang Seng Index, Shanghai Composite, and Brazil Bovespa were all positive on the week with gains of 2.27%, 3.09%, and 3.36% respectively. Most global stock markets remain in negative trends.


Chart 6: The Shanghai Composite has been in an aggressive negative trend throughout the course of 2018. The 50, 100, and 200 day moving averages are all moving in a downward direction.

SELECTED INTEREST RATES

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| 2-Yr. U.S. Treasury | 2.80% | 2 bps | NM | NM |
| 5-Yr. U.S. Treasury | 2.89% | -15 bps | NM | NM |
| 10-Yr. U.S. Treasury | 3.07% | -12 bps | NM | NM |
| 30-Yr. U.S. Treasury | 3.33% | -6 bps | NM | NM |
| German 10-Yr. Govt. | 0.37% | 4 bps | NM | NM |
| France 10-Yr. | 0.76% | 2 bps | NM | NM |
| Italy 10-Yr. | 3.49% | -7 bps | NM | NM |
| Fed 5-Yr Fwd BE Inf. | 2.06% | -1 bps | NM | NM |

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| Prime Rate | 5.25% | 0.00 | NM | NM |
| Fed Funds Rate | 2.25% | 0.00 | NM | NM |
| Discount Rate | 2.75% | 0.00 | NM | NM |
| LIBOR (3 Mo.) | 2.64% | 2 bps | NM | NM |
| Bond Buyer 40 Muni | 4.45% | -9 bps | NM | NM |
| Bond Buyer 40 G.O. | 4.30% | NA | NM | NM |
| Bond Buyer 40 Rev. | 4.79% | NA | NM | NM |

Source: Bloomberg

Table 2: Interest rates as of November 16th, 2018. Courtesy of Envestnet | PMC

US Treasury bonds dropped significantly on the week. Treasuries made some significant gains over the week. The 10 year US Treasury Bond rallied almost a percent, finishing the week up 0.90% as interest rates fell -12 bps. Interest rates rose on German and French bonds.


Chart 7: The Long-term Treasury Bond ETF (iShares symbol TLT) remains in a negative trend despite the positive week.

SELECTED CURRENCY PERFORMANCE

| | Last | Change | % Chg. | YTD % | | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|---|---|---|---|---|
| Dollar Index | 96.45 | -0.451 | -0.47% | 4.70% | Chinese Yuan | 6.94 | -0.019 | 0.27% | -6.22% |
| Euro | 1.14 | 0.008 | 0.70% | -4.91% | Swiss Franc | 1.00 | -0.006 | 0.59% | -2.54% |
| Japanese Yen | 112.87 | -0.950 | 0.84% | -0.17% | New Zealand Dollar | 0.69 | 0.014 | 2.14% | -3.06% |
| British Pound | 1.28 | -0.015 | -1.13% | -5.08% | Brazilian Real | 3.74 | 0.009 | -0.23% | -11.51% |
| Canadian Dollar | 1.32 | -0.006 | 0.45% | -4.42% | Mexican Peso | 20.14 | 0.034 | -0.17% | -2.53% |

Source: Bloomberg

**Table 3: Currency Performance as of November 16th, 2018. Courtesy of Envestnet | PMC**

The Dollar index dropped this week as the Euro, Yen, Canadian Dollar, Swiss Franc, and Chinese Yuan gained ground. The New Zealand Dollar was the strongest currency last week, gaining 2.14%. The weakest was the British Pound, which lost -1.13% over the week.


**Chart 8: The Australian Dollar/Japanese Yen currency cross (red/black line) has been historically correlated to the MSCI World Index ex-US (black line). We will be watching this currency pairing for potential strength as this can be indicative of improving risk appetite in global stocks.**

SELECTED COMMODITY MARKET PERFORMANCE

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| Bloomberg Comm. Idx. | 83.91 | 1.02 | 1.23% | -4.83% |
| Crude Oil | $56.83 | -$3.39 | -5.63% | -2.19% |
| Natural Gas | $4.35 | $0.63 | 16.97% | 45.15% |
| Gasoline ($/Gal.) | $2.65 | -$0.06 | -2.14% | 6.72% |
| Heating Oil | 207.98 | -9.36 | -4.31% | 6.37% |
| Gold Spot | $1,221.58 | $11.86 | 0.98% | -6.24% |
| Silver Spot | $14.41 | $0.26 | 1.83% | -14.90% |

| | Last | Change | % Chg. | YTD % |
|---|---|---|---|---|
| Platinum Spot | $845.74 | -$7.65 | -0.90% | -8.92% |
| Corn | 375.75 | -5.50 | -1.44% | -4.45% |
| Wheat | 515.25 | 3.00 | 0.59% | 4.46% |
| Soybeans | 892.25 | 5.50 | 0.62% | -9.23% |
| Sugar | 12.69 | -0.04 | -0.31% | -19.12% |
| Orange Juice | 137.30 | 1.15 | 0.84% | -4.19% |
| Aluminum | 1,929.00 | -25.00 | -1.28% | -14.95% |
| Copper | 6,184.00 | 128.00 | 2.11% | -14.67% |

Source: Bloomberg; % change is based on price.

**Table 4: Commodities Prices as of November 16th, 2018. Courtesy of Envestnet | PMC**

The Bloomberg Commodity index gained 1.23% over the week. Natural gas was the strongest gainer over the week, closing up 16.97%. Crude oil lost -5.63% on the week. Gold gained almost a percent on the week as investors sought refuge in the yellow metal.


**Chart 9: Oil is tanking this year. We believe the drop in crude is indicative of slowing inflation.**

# INTERMARKET RELATIONSHIPS


**Chart 10: Stocks broke down versus bonds in the month of October. Since then this relationship has consolidated around the 200 day moving average. We would like to see this relationship break above the old highs set in September in order to suggest a positive risk-taking environment.**


**Chart 11: Stocks broke down below the 200 day moving average against Gold in October. Since then, this ratio has reclaimed the 200 day, but remains below the highs set in September.**


**Chart 12: US stocks continue to dominate international markets. The S&P 500 equal weight index is getting close to breaking to all time highs against the MSCI All World Ex-US index.**


**Chart 13: The MSCI EAFE/MSCI Emerging Markets ratio closed below the 200 day moving average for the first week since June. This indicates that the relative strength advantage for developed markets is evaporating relative to emerging markets. We think this would be an encouraging shift as it would demonstrate an increased risk appetite.**


**Chart 14: Large Cap US stocks remain favored over small cap stocks. We would like to see this ratio break into a negative trend in favor of small cap stocks as this would be indicative of a return seeking environment.**


**Chart 15: High Quality, value stocks, like those that comprise the Vanguard Dividend Appreciation index are gaining extreme strength against the broader large cap market.**


**Chart 16: Consumer Staples (defensive) are showing positive relative strength against Consumer Discretionary (cyclical). This is suggestive of a defensive posture in the markets currently.**

# MARKET INTERNALS

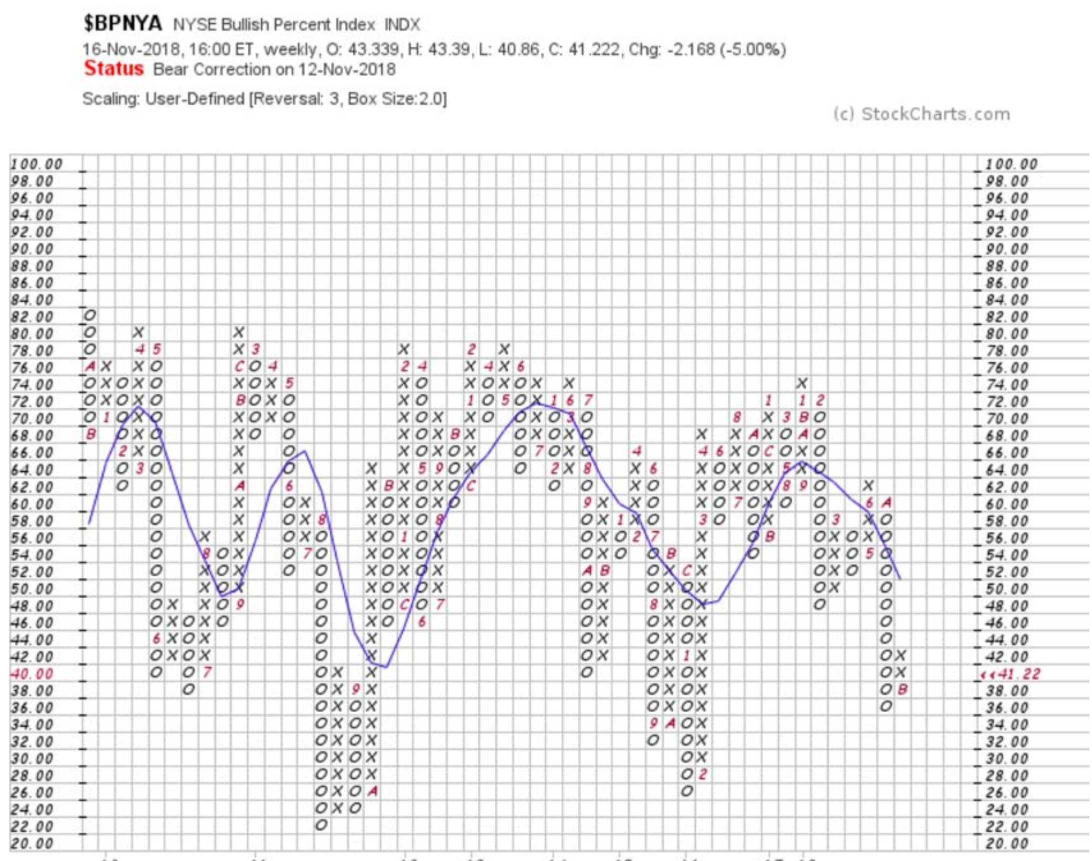


**Chart 17: The Percentage of Stocks in the NYSE on point and figure buy signals is currently 41%. The positive news is that this indicator is currently in a column of Xs suggesting that this number is improving. This measure of market breadth tends to get oversold in bull markets around the 40% level and overbought above 75%. In bear markets, this indicator gets oversold around 20% and overbought around 65%.**


**Chart 18: Only about 33% of the stocks in the NYSE are above their 200 day moving average.**


**Chart 19: The cumulative advance-decline line of the S&P 500 is still in a strong positive trend. This commonly used measure of market breadth is not confirming the negative trend in the price of the S&P 500. Instead it is diverging positively.**

# THE OBVIOUS PATTERN…

There is a common chart pattern in technical analysis called the head and shoulders pattern. There are actually two versions of this pattern, a topping pattern (traditional head and shoulders) and a bottoming pattern (an inverse head and shoulders). Currently on the S&P 500, it appears that an inverse head and shoulders pattern is attempting to form. In this pattern, a break above the neckline can mean a positive outcome for the stock market.


**Chart 20: Inverse Head and Shoulders potential in the S&P 500.**

In the illustration we have drawn out how a typical inverse head and shoulders pattern can resolve itself. The market would have to rally from here (not completely out of the realm of possibility considering holiday season, Black Friday, G20, etc.) to break the neckline at the 2810 level on the S&P 500. This implies approximately a 70 point move by the S&P 500. If this occurs, the pattern is engaged and a measured move to around 3000 on the S&P 500 could be expected. This would be a welcome occurrence given the present environment and our framework being so negative.

A breakout to new highs by the S&P 500 would reverse the current negative trend back to positive. We welcome this potential pattern although it is too early to determine if this will be confirmed. This is something we will be watching over the next several weeks.

# CRYPTO CURRENCIES

Not a good week for crypto with breakdowns across the board. Checkout the charts of Bitcoin and Ethereum below. Both remain in negative short, intermediate, and long-term trends.


**Chart 21: Bitcoin crashed this week and broke out below a long-held support line. This is not positive for crypto in general and could mean more pain ahead.**

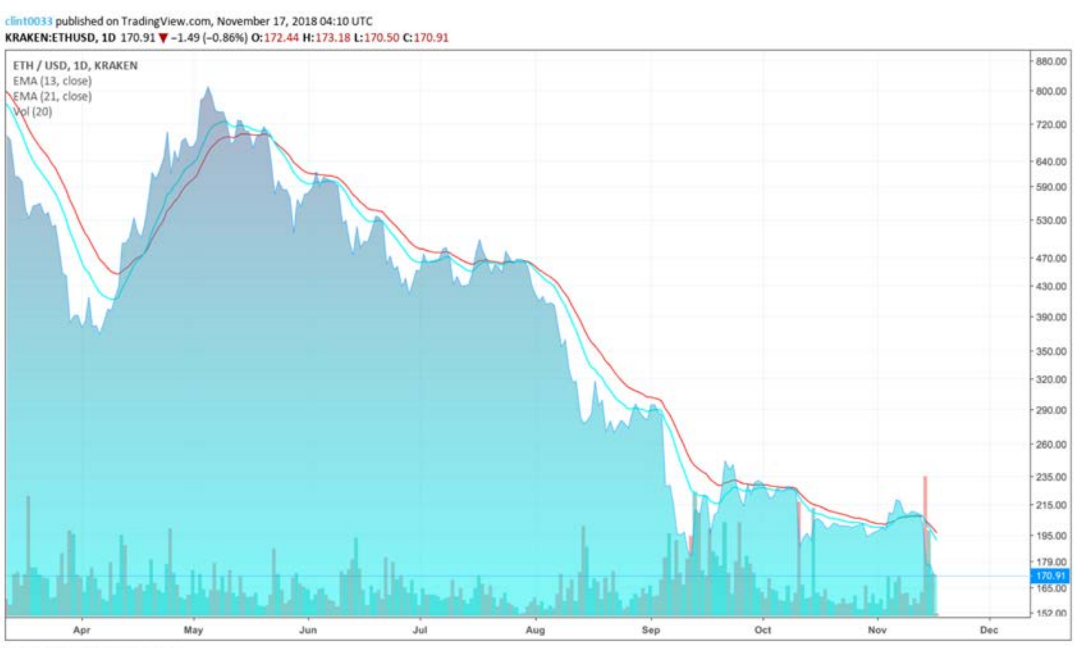


**Chart 22: Ethereum remains in the negative trend started in late May. Since then it has dropped from over $600 to $170.**

# WHERE DOES THIS LEAVE US?

Our investment framework still has us in a cautious position towards risk assets at the present moment.  There are some positive signs in the markets, such as certain breadth measures, short term strength in emerging markets, and a potential bottoming pattern in the S&P 500 developing. Also, the Federal Reserve appears to be pivoting to a potentially more dovish stance by becoming more “data dependent”.  However, the evidence is still supportive of a defensive posture. Growth and inflation are slowing, valuations are high, the Fed is tightening policy, and the long-term trend in global stocks is down. Until we have a meaningful positive shift in these components our recommendation is to sit patiently and observe.

# DISCLOSURE:

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