



WEALTHSHIELD

December 3rd, 2018

NOW WHAT?

We got the oversold rally due to the markets this past week as the S&P 500 rallied right to the 2750-2800 resistance zone. This was enough to clear the short-term oversold condition in the S&P 500, triggered at the end of the Thanksgiving Holiday week. Now the S&P 500 is short-term overbought.

There could be further upside in equities if the G20 meeting results in Trump not moving forward with additional tariffs, and instead pursuing further discussions with China on trade. Tariffs and a weak Chinese stock market have negatively impacted global growth and inflation trends this year. China is down almost -22% year to date, bringing down emerging markets (-12.25%) with it. Positive developments on trade could help revive Chinese and emerging market equities, at least we hope this is the case.

The market got what it needed last week to get some momentum started as Federal Reserve chairman Powell moved markets with his speech. He claimed that interest rates were right below the neutral rate, sparking a buying frenzy in stock markets. Now markets expect the Fed to hike only two more times before pausing. The Dovish switch by Powell is exactly what typically occurs in response to growth and inflation slowing. If the trend continues to the downside, we expect the Fed to pause interest rate increases and balance sheet reductions next year.

Although the market has rallied and cleared the oversold conditions of the previous week, and the Fed has tilted its communication to a more Dovish stance, the facts remain that our framework warns us to be defensive. We believe valuations are still indicating that the S&P 500 will yield negative returns over the next 10-12 years. Dr. Hussman adds color to this assessment in his most [recent market commentary](#):

“With the most reliable measures of market valuation still over 2.5 times their historical norms, there are essentially two ways to normalize valuations. One is for the market to lose about -60% of its value. The other is for fundamentals to grow while leaving stock prices unchanged. So the question is: how many years of growth would be required in order to normalize valuations? The answer is $\ln(2.5)/\ln(1.04) = \text{over } 23 \text{ years}$. Though prices would be unchanged, you’d also get a dividend yield of about 2% while you wait.”

Dr. Hussman isn't the only market watcher to suggest low returns are here. Ray Dalio, the founder of the uber-successful hedge fund, Bridgewater, said the following in an interview with Bloomberg:

"I think we're in an environment where we're going to have low returns going forward for a very, very long time."

Market trends remain negative within our framework as a majority of the asset classes we follow are below their 10 month moving averages. Furthermore, intermarket trends are in favor of defensive exposures versus offensive ones. Fed policy and economic growth are also "red" within our framework. Despite the Fed communicating more Dovish, the fact remains that they are still tightening into a slowdown in growth and inflation. Our business cycle framework warrants a defensive posture at the moment. We hope Dr. Hussman is wrong and the market doesn't have to collapse -60% or take 23 years of unchanged prices and growth to correct the highly valued conditions of today. Nevertheless, we aim to be prepared, and we want you to be prepared as well.

If markets resume their uptrends and economic growth resumes its upward trajectory, we will be more inclined to take on an offensive posture. Until then, we will remain in favor of risk mitigation strategies and playing a little defense.



Chart 1: S&P 500 rallied to close right below the 200 day moving average, clearing the short-term oversold conditions of the previous week.

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ECOMONIC UPDATE

We had a lot of economic data last week. There were several data releases relating to the housing market. All of these data points were disappointing relative to consensus estimates. The Case Shiller Home Price index grew at 5.1%, down from 5.5% in the previous month. New homes sales dropped -8.9% from the previous month and pending home sales are now down -6.7% year over year. The second estimate for real GDP came in unchanged at 3.5%. The ECRI Weekly leading index is now down -4% year over year. The four week moving average of the ECRI Weekly Leading Index is negative for the first time since 2016, down -0.56% year over year. The data continues to confirm that growth is slowing.

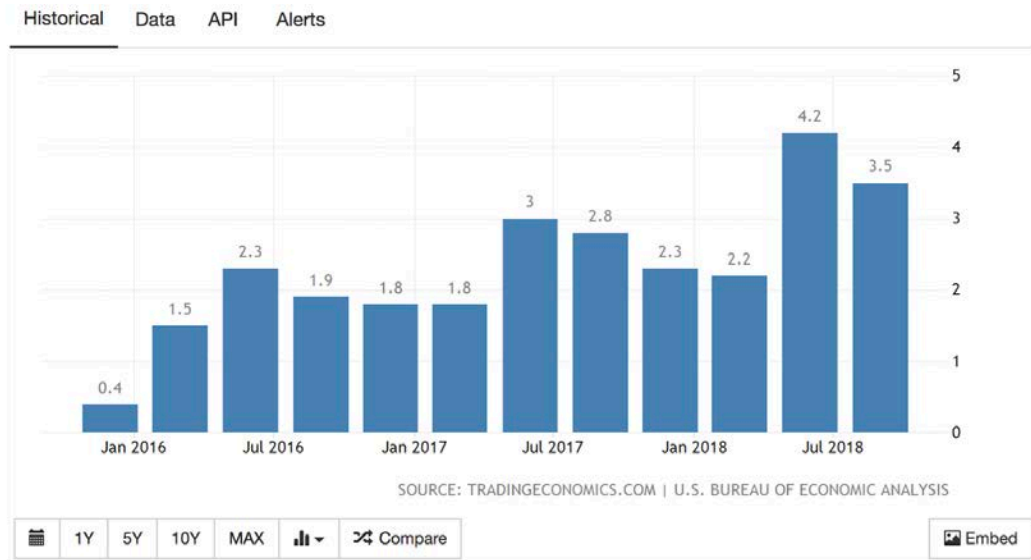


Chart 2: Real GDP currently stands at 3.5% for the 3rd Quarter.

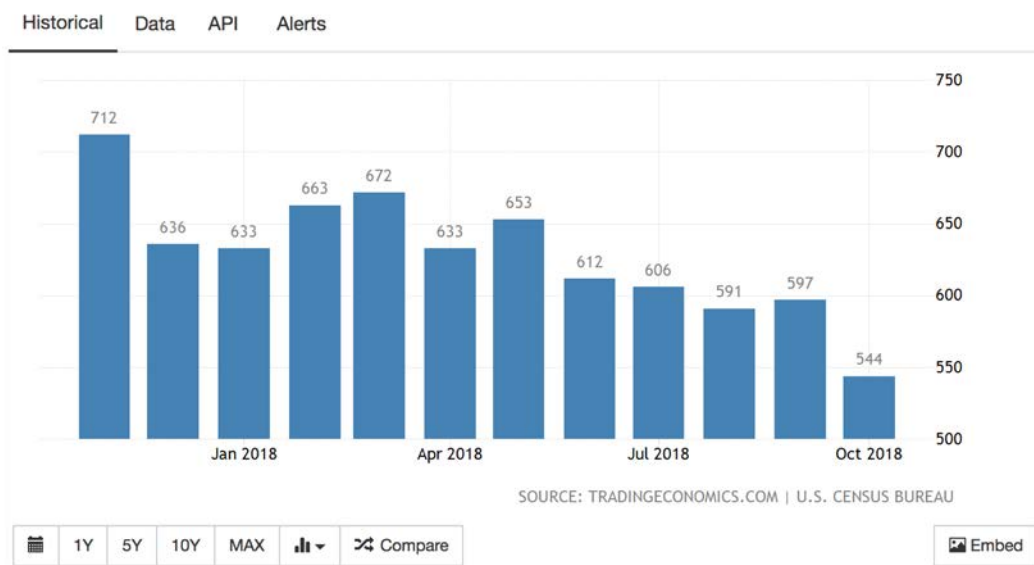


Chart 3: New Home sales dropped -8.9% on a month over month basis.

ECOMONIC UPDATE

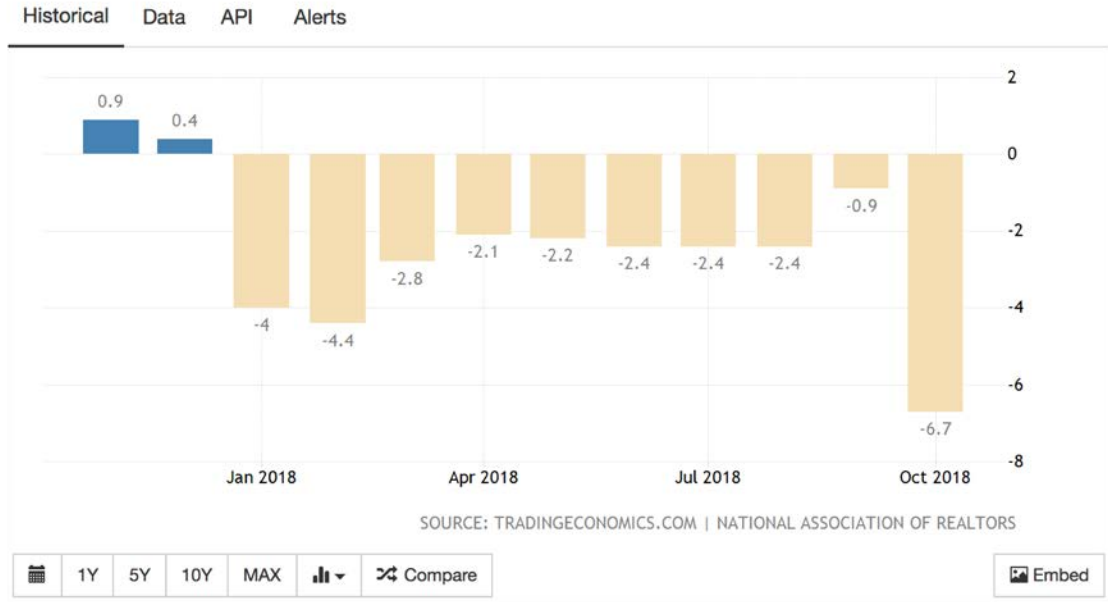


Chart 4: Pending home sales are down -6.7% year over year.

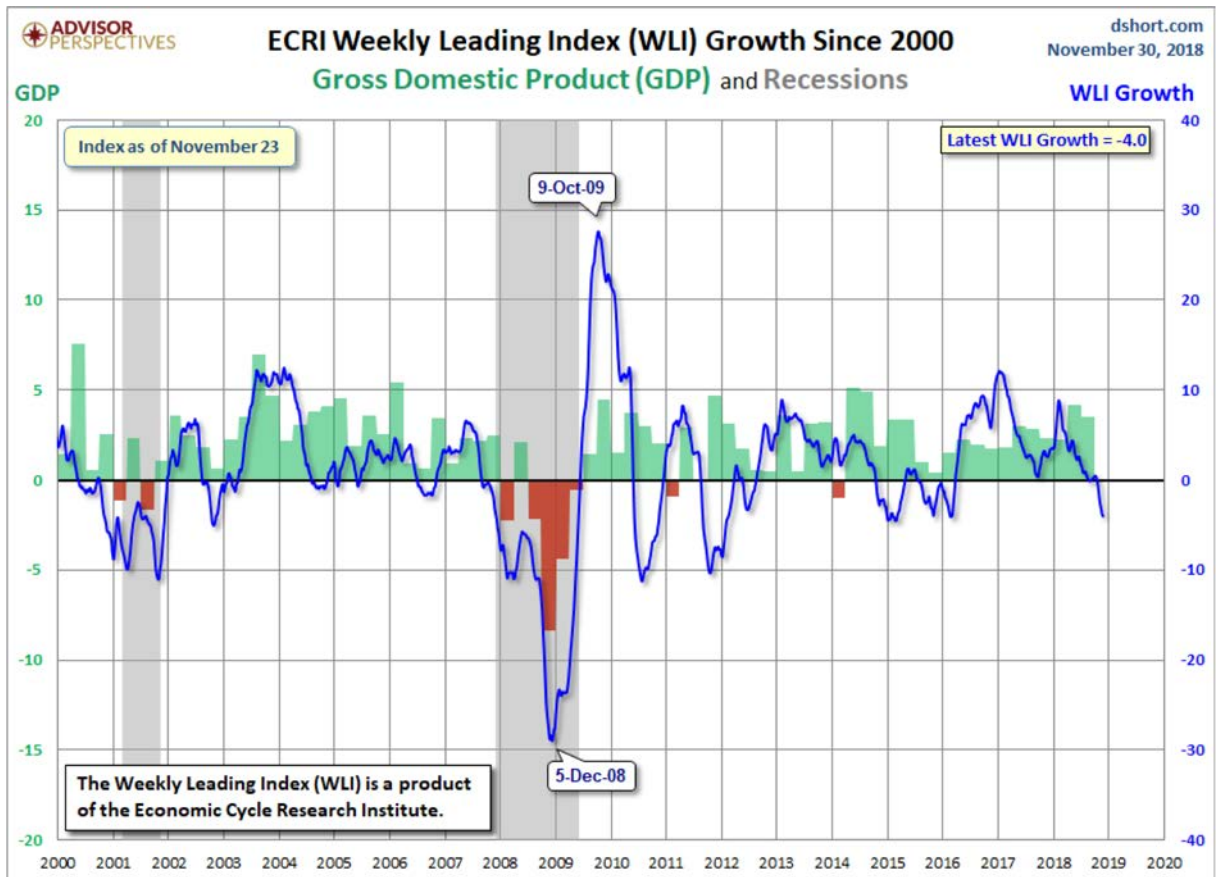


Chart 5: The ECRI WLI is down 4.0% year over year after the most recent data.

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ECOMONIC UPDATE

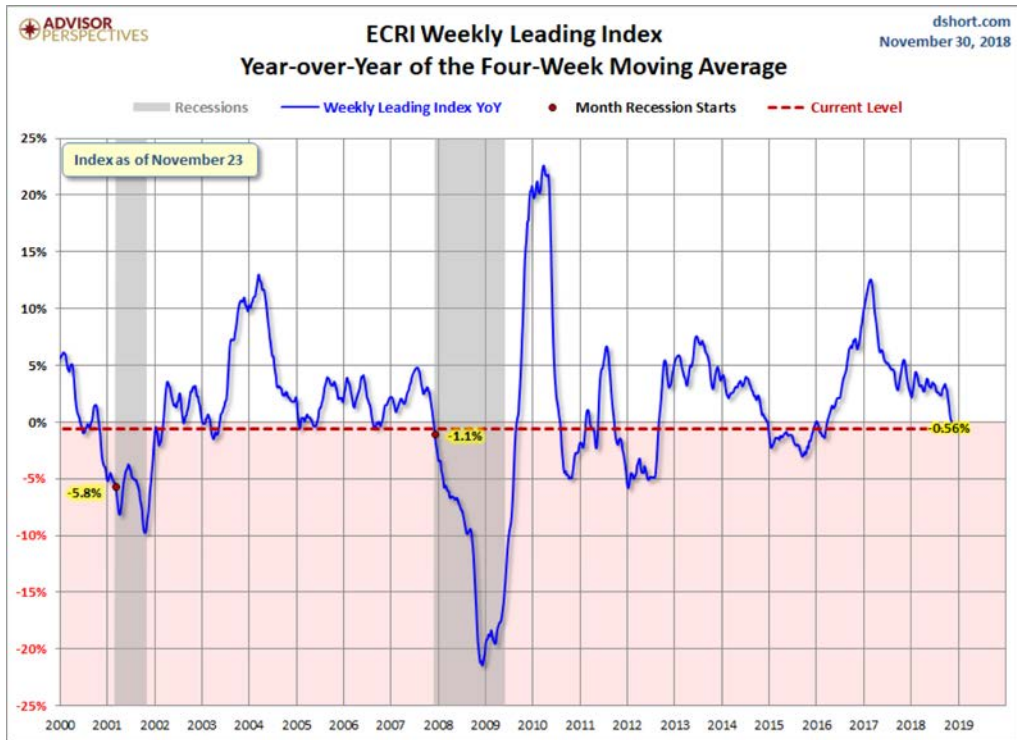


Chart 6: The four week moving average of the ECRI Weekly Leading Index is now negative (-0.56%) year over year.

ECOMONIC CALENDAR:

This week we get ISM reports for manufacturing and non-manufacturing data. We also get the Jobs report on Friday to cap off the week. We have included the table below with previous numbers and consensus estimates for each of the key data releases this week.

				Actual	Previous	Consensus	Forecast	
Monday December 03 2018								
10:00 AM		US	ISM Manufacturing PMI NOV		57.7	57.8	57	
Wednesday December 05 2018				Actual	Previous	Consensus	Forecast	
10:00 AM		US	ISM Non-Manufacturing PMI NOV		60.3	59.7	59	
Thursday December 06 2018				Actual	Previous	Consensus	Forecast	
08:30 AM		US	Balance of Trade OCT		\$-54B	\$-54.9B	\$-55.4B	
Friday December 07 2018				Actual	Previous	Consensus	Forecast	
08:30 AM		US	Non Farm Payrolls NOV		250K	200K	189K	
10:00 AM		US	Michigan Consumer Sentiment Prel DEC		97.5	97.0	96	

Source: Tradingeconomics.com

EQUITY MARKET REVIEW

WORLD MARKET PERFORMANCE

	Last	Change	% Chg.	YTD %		Last	Change	% Chg.	YTD %
S&P 500	2,760.16	127.60	4.85%	3.24%	Swiss Market Index	9,037.76	191.86	2.17%	-3.67%
Dow Industrials	25,538.46	1252.51	5.16%	3.31%	CAC 40 Index (France)	5,003.92	56.97	1.15%	-5.81%
Nasdaq Composite	7,330.54	391.55	5.64%	6.19%	DAX Index (Germany)	11,257.24	64.55	0.58%	-12.85%
Russell Global	2,031.14	57.57	2.91%	-5.0%	Irish Overall Index	5,818.65	-109.56	-1.85%	-17.33%
Russell Global EM	3,119.47	87.24	2.88%	-14.4%	Nikkei 225	22,351.06	704.51	3.25%	-1.82%
S&P/TSX (Canada)	15,197.82	187.09	1.25%	-6.24%	Hang Seng Index	26,506.75	579.07	2.23%	-11.41%
Mexico IPC	41,732.78	588.45	1.43%	-15.44%	Shanghai Composite	2,588.19	8.70	0.34%	-21.74%
Brazil Bovespa	89,504.06	3273.81	3.80%	17.15%	Kospi Index (S. Korea)	2,096.86	39.38	1.91%	-15.02%
Euro Stoxx 600	357.49	3.51	0.99%	-8.14%	Taiwan Taiex Index	9,888.03	220.73	2.28%	-7.09%
FTSE 100	6,980.24	27.38	0.39%	-9.20%	Tel Aviv 25 Index	1,629.94	22.40	1.39%	7.96%
IBEX 35 (Spain)	9,077.20	160.50	1.80%	-9.62%	MOEX Index (Russia)	2,392.50	49.53	2.11%	13.40%

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

Table 1: Equities as of November 30th, 2018; Source: Envestnet | PMC

This past week saw a relief rally in global equities. The oversold conditions of the previous week were largely cleared. The S&P 500 rallied almost 5% last week. The Russell Global index rallied 2.91%. The top performing index was the Nasdaq composite, finishing up 5.64% for the week. The worst performer was the Irish Overall Index, which dropped -1.85% for the week.



Chart 7: The Wilshire 5000 stock market index rose 4.60% but remains in a long-term negative trend

INTEREST RATES

The rate on the benchmark 10 year yield was down slightly over the week. Interestingly, interest rates broke through key short-term support, which indicates a short-term downtrend in the 10 year yield.

SELECTED INTEREST RATES

	Last	Change	% Chg.	YTD %		Last	Change	% Chg.	YTD %
2-Yr. U.S. Treasury	2.80%	0 bps	NM	NM	Prime Rate	5.25%	0.00	NM	NM
5-Yr. U.S. Treasury	2.85%	-3 bps	NM	NM	Fed Funds Rate	2.25%	0.00	NM	NM
10-Yr. U.S. Treasury	3.01%	-4 bps	NM	NM	Discount Rate	2.75%	0.00	NM	NM
30-Yr. U.S. Treasury	3.31%	0 bps	NM	NM	LIBOR (3 Mo.)	2.74%	5 bps	NM	NM
German 10-Yr. Govt.	0.31%	3 bps	NM	NM	Bond Buyer 40 Muni	4.30%	-4 bps	NM	NM
France 10-Yr.	0.68%	4 bps	NM	NM	Bond Buyer 40 G.O.	4.22%	NA	NM	NM
Italy 10-Yr.	3.21%	16 bps	NM	NM	Bond Buyer 40 Rev.	4.68%	NA	NM	NM
Fed 5-Yr Fwd BE Inf.	2.04%	1 bps	NM	NM					

Source: Bloomberg

Table 2: Interest Rates as of November 30th, 2018; Source: Investnet | PMC



Chart 8: The US 10 year interest rate dropped below below the 50 and 100 day moving averages. A potential trend change may be upon us. Have we seen the top in interest rates for the cycle?

CURRENCIES

The US dollar index rose 0.31% last week. The New Zealand Dollar was also up 1.39% and was the only other currency on the week. The strong dollar should continue to pressure inflation and growth going forward, reiterating our growth and inflation slowing outlook.

SELECTED CURRENCY PERFORMANCE

	Last	Change	% Chg.	YTD %		Last	Change	% Chg.	YTD %
Dollar Index	97.23	0.301	0.31%	5.53%	Chinese Yuan	6.96	0.012	-0.17%	-6.52%
Euro	1.13	-0.002	-0.19%	-5.74%	Swiss Franc	1.00	0.002	-0.17%	-2.48%
Japanese Yen	113.54	0.590	-0.52%	-0.76%	New Zealand Dollar	0.69	0.009	1.39%	-3.14%
British Pound	1.27	-0.007	-0.56%	-5.71%	Brazilian Real	3.87	0.038	-0.99%	-14.43%
Canadian Dollar	1.33	0.006	-0.41%	-5.43%	Mexican Peso	20.40	0.005	-0.03%	-3.69%

Source: Bloomberg

Table 3: Currencies as of November 30th, 2018; Source: Envestnet | PMC



Chart 9: The US dollar remains in a positive trend.

COMMODITIES

The Bloomberg Commodity Index rallied 1.32% last week. The biggest gainers last week were natural gas (6.25%) and sugar (2.97%). The biggest loser was platinum (-5.39%). Crude oil was up slightly (0.58%) after collapsing -11% the week before.

SELECTED COMMODITY MARKET PERFORMANCE

	Last	Change	% Chg.	YTD %		Last	Change	% Chg.	YTD %
Bloomberg Comm. Idx.	82.56	1.08	1.32%	-6.36%	Platinum Spot	\$798.07	-\$45.48	-5.39%	-14.03%
Crude Oil	\$50.72	\$0.29	0.58%	-12.19%	Corn	377.75	7.25	1.96%	-3.94%
Natural Gas	\$4.63	\$0.27	6.25%	50.18%	Wheat	515.75	8.50	1.68%	4.56%
Gasoline (\$/Gal.)	\$2.49	-\$0.07	-2.88%	0.24%	Soybeans	894.75	13.75	1.56%	-8.98%
Heating Oil	182.57	-4.57	-2.44%	-6.62%	Sugar	12.84	0.37	2.97%	-18.16%
Gold Spot	\$1,221.93	-\$1.29	-0.11%	-6.22%	Orange Juice	143.95	2.35	1.66%	0.45%
Silver Spot	\$14.18	-\$0.12	-0.81%	-16.32%	Aluminum	1,940.00	-9.00	-0.46%	-14.46%
					Copper	6,212.00	5.00	0.08%	-14.28%

Source: Bloomberg; % change is based on price.

Table 4: Commodities as of November 30th, 2018; Source: Envestnet | PMC



Chart 10: The CRB index was up last week, but remains in a downtrend. This suggests that inflation expectations are coming down.

MARKET TRENDS:



Chart 11: Stocks versus bonds: Stocks are in a negative trend relative to bonds, suggesting a defensive posture is warranted.



Chart 12: Stocks versus Gold. Stocks are in a negative trend relative to gold.

MARKET TRENDS:



Chart 13: US stocks versus International stocks: US stocks broke out to new highs relative to International stocks and are in a positive trend.



Chart 14: International Developed versus Emerging. International developed markets remain in a positive trend relative to emerging markets. Emerging markets gained almost 2% against international developed last week.

MARKET TRENDS:



Chart 15: Small caps versus large caps. Small cap stocks are in a negative trend relative to large cap stocks. This trend accelerated last week with small caps dropping 2% against large cap stocks.

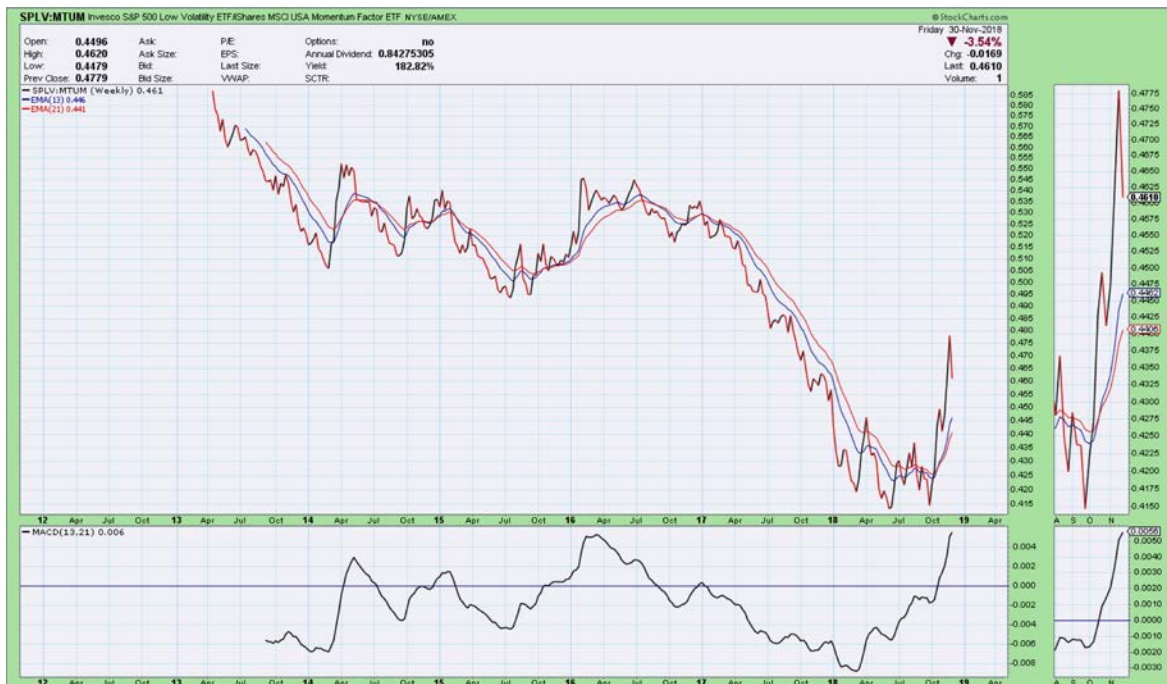


Chart 16: Low volatility versus momentum: The low volatility ETF (SPLV) dropped -3.54% against the momentum factor ETF (MTUM). Low volatility remains in a positive trend versus momentum.

MARKET TRENDS:



Chart 17: Dividend growth stocks (VIG) versus Large Cap Growth (VUG). Dividend growth stocks, as a style, are outperforming growth stocks. Dividend growth stocks are in a long-term positive trend relative to growth. This is typical of a late-cycle environment.



Chart 18: High Yield bonds versus Treasuries. The High Yield bond to Intermediate treasury bond ratio is in a long-term negative trend.

MARKET TRENDS:

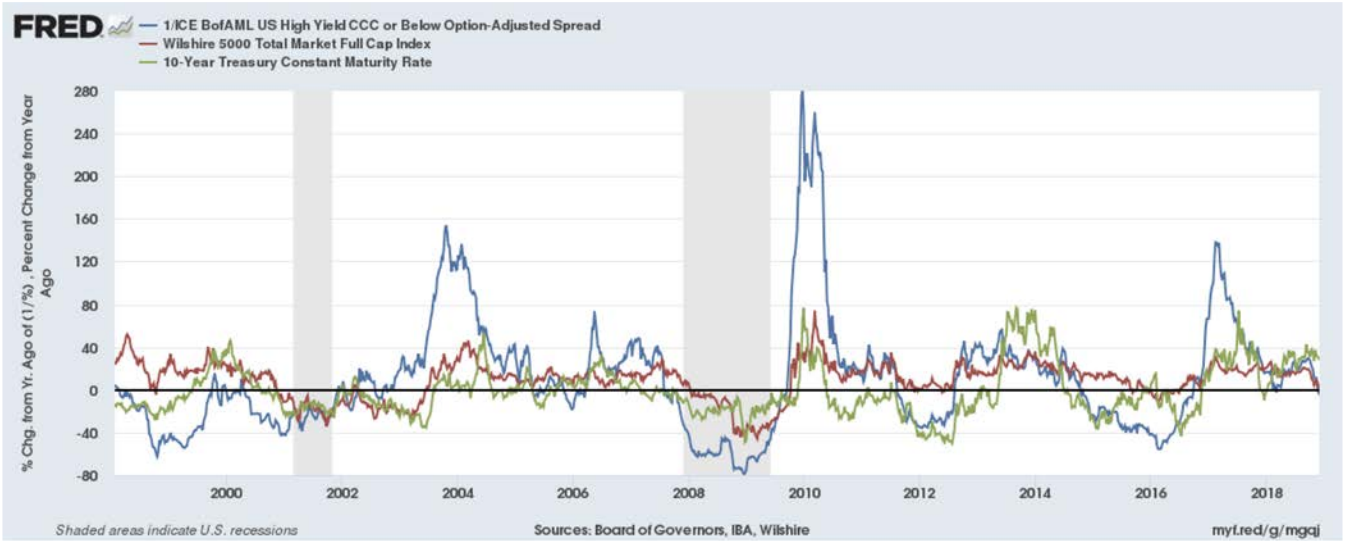


Chart 19: Credit spreads, rates, and stocks. Credit spreads (blue line inverted) are highly correlated with stocks and interest rates. Credit spreads are widening, indicating that credit is under pressure. Stocks (red) are responding and moving down as well. We expect interest rates to follow (green).



Chart 20: Copper versus Gold. Copper is in a negative trend relative to Gold suggesting inflation and growth are slowing.

CRYPTO:

clint0033 published on TradingView.com, December 01, 2018 15:35 UTC

COINBASE:BTCUSD, D 4141.40 ▲ +165.40 (+4.16%) O:3976.01 H:4184.99 L:3910.08 C:4141.40



Created with TradingView

Chart 21: Bitcoin remains in a negative trend and is down. It rose about 5% over the week.

clint0033 published on TradingView.com, December 01, 2018 15:38 UTC

KRAKEN:ETHUSD, D 116.76 ▲ +5.12 (+4.59%) O:111.81 H:119.44 L:109.84 C:116.76



Created with TradingView

Chart 22: Ethereum was up about 2% for the week, but remains in a long-term negative trend.

INVESTMENT PLAYBOOK:

Underweight Ideas

Momentum Factor: MTUM
Oil and Gas Exploration: XOP
Semiconductors: SMH
Credit bonds: HYG, JNK, SJNK
Emerging market equities: EEM,
VWO

Overweight Ideas:

Long Term Treasuries: TLT, EDV, ZROZ
Housing stocks: ITB, XHB
Dividend Growth: VIG, DGRO, NOBL
Low Volatility US: SPLV
Defensive Sectors: Reits (XLRE),
Healthcare (XLV), Staples (XLP),
Utilities (XLU).
US Dollar: UUP

Long Term Watchlist*:

Chinese Internet sector: KWEB
Long China, short US: CNYA/SPY
Bitcoin and Bitcoin futures

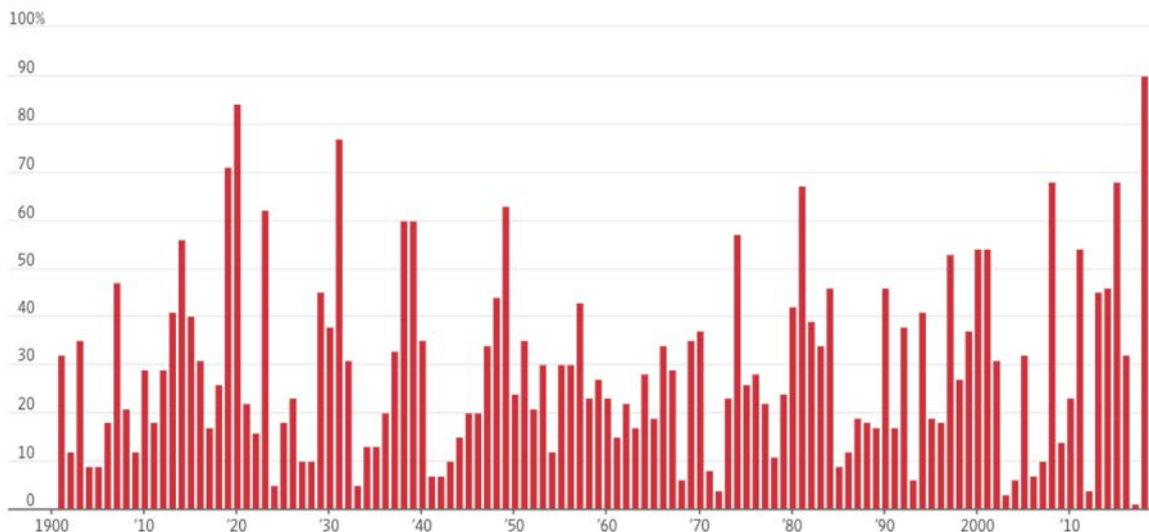
**Not on current buy signals*

CHART OF THE WEEK:

This is what a bear market looks like:

Under Pressure

A record share of asset classes have posted negative total returns this year, according to Deutsche Bank data going back to 1901.



Note: Returns are in U.S. dollars. Data for 2018 are as of mid-November.

Sources: Deutsche Bank; Bloomberg Finance LP; GFD

Chart 23: According to a study by Deutsche Bank, since 1901 there has never been a higher share of asset classes with negative total returns than this year. 90% of the asset classes tracked have negative total returns highlighting the difficulty of this investment year.

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SUMMARY:

Every component of our framework is negative for the first time in our organizations history. We don't want to underplay the potential ramifications of this. We are not charged with the task of predicting recessions. Instead we work to help our advisors navigate the markets by guiding them to put the offensive team or defensive team on the field. Right now, we believe advisors should be following the defensive playbook.

As Bear Bryant, the former Alabama football coach, espoused, "offense sells tickets, but defense wins championships." Investors do not have to play offense all the time. At times, defense is necessary. Right now, according to our discipline, defense is necessary.

We welcome a change in trend, an end to monetary tightening, and a resurgence of growth. However, just because we wish it would happen doesn't mean it will. Until then we will use the playbook we believe is necessary for the current market environment.

WEALTHSHIELD

DISCLOSURE:

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