



Market Outlook | March 25th, 2019

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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?



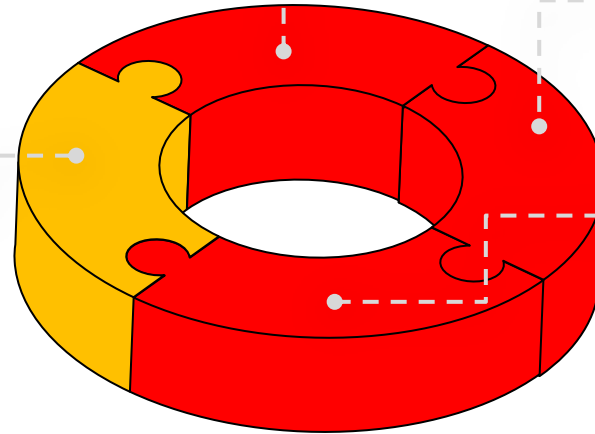
FEDERAL RESERVE ACTIVITY

Expansionary or Restrictive?



ECONOMIC ACTIVITY

Is the economy growing or shrinking?



NEGATIVE DIVERGENCES

Over the last several weeks, divergences have been stacking up. According to Investopedia, “*divergence is when the price of an asset is moving in the opposite direction of a technical [indicator](#), such as an oscillator, or is moving contrary to other data. Divergence warns that the current price [trend](#) may be weakening, and in some cases may lead to the price changing direction. There is positive and negative divergence. [Positive divergence](#) indicates a move higher in the price of the asset is possible. Negative divergence signals that a move lower in the asset is possible.*” We are skeptical of the rally being a bull trap due to the fact that the divergences we have seen recently have been largely negative in nature.

Divergence is not a new concept within market analysis. One of the main tenets of Dow Theory is that the Dow Jones Industrial and Dow Jones Transport indices must confirm one another. For instance, for a primary up trend in the market, both the Dow Transports and Dow Industrials index must be breaking to highs. Today, we have the Dow Jones Industrials breaking above resistance and closing at intermediate term highs, but the Dow Jones Transports is failing to break higher. In fact, the Dow Jones Transports not only failed to break resistance, but also broke through support last week. The weak performance out of Transports should serve as a warning signal for equity investors.

Recently, we have also seen negative divergences in several technical indicators, factors, fundamentals, and sectors. There are a few divergences worth specifically noting. Small caps dropped against large-caps while the S&P continued higher (until last week), and the percentage of stocks in the S&P 500 that are on point and figure buy signals (bullish percent index) failed to reach new highs at the same time that the price index broke above resistance. In addition, the strength in low volatility and quality factors, the weakness in global economic activity, and the fact that 60% of the yield curve is now inverted all signal caution.

Price and market trend are important variables within our market framework. If forced to choose, we would probably say they are the most important variables. However, when divergences abound, a prudent investor is typically rewarded for following a process that is robust and well rounded. We believe that ours is just that. Therefore, our recommendation is to continue to overweight defensive exposures within all asset classes. In equities, this means high quality, low volatility factors, dividend growth, utilities, staples, healthcare, and REITS. Within fixed income, we recommend Treasuries or high quality municipals. Global macro, long-term diversified trend following, market neutral, real estate, and long-short equity are our defensive recommendations in the alternative investments category.

WEEKLY SUMMARY

The biggest economic news last week was the Fed meeting. The Federal Reserve, under Jerome Powell, was successfully able to further their dovish pivot for the third time in three months. Now, the Fed is saying they are done with interest rate increases for the rest of the year and that the balance sheet reduction program will be done by October. In our opinion, this is the proper response to a growth and inflation slowing environment. In fact, we would not be surprised to see the Fed ease policy through a rate cut by the end of the year. The path is first to ease through communication (which they are doing now), then to cut rates, and finally to buy bonds through QE. As long as growth is slowing, we expect the Fed to ease policy.

In regards to the growth trend in the US economy, it is still negative. Despite rising 0.3 last week, the ECRI Weekly Leading Index is still down -2.95% year over year. The leading index is moving in the right direction but still indicative of an economic growth slowdown. The year over year percentage change of the four week moving average is down -3.22%.

The VIX rallied 27.95% week over week as equity market volatility surged on Friday. The Vanguard Total World Stock Market ETF (VT) was down -1.16% over the week. China was the clear leader globally, up 2.73% last week. The S&P 500 was down -0.77%. The leading sectors were consumer discretionary, REITS, staples, and utilities. Momentum was the leading factor, down -0.13%.

The Russell 2000 was the clear laggard last week, finishing down -3.06%. The weakness in small caps is one of the most important negative divergences in the market. This divergence led the market decline in September, and over the last several weeks it has broken down below the December lows.

The 20 year plus Treasury Bond ETF (TLT) was up 2.55% last week. The combination of the dovish Fed and the rise in equity market volatility caused interest rates to drop significantly. The long end dropped faster than the short end of the curve, and we saw significant inversions throughout the yield curve. The most significant is the inversion of the 3 month T Bill and 10 year Treasury note. This particular relationship is one of the most historically accurate suggestions of a recession.

Gold was up 0.72%, the Dollar was up 0.11%, and the Commodities index (CRB) was up 0.16%. The week was largely risk-off due to the action on Friday. We will have to wait and see whether there is continuation this week.



Chart 1: Dow Theory. Classic negative non-confirmation.



Chart 2: The Bullish percent index is negatively diverging from market prices.

ECRI Weekly Leading Index (WLI) Growth Since 2000

Gross Domestic Product (GDP) and Recessions

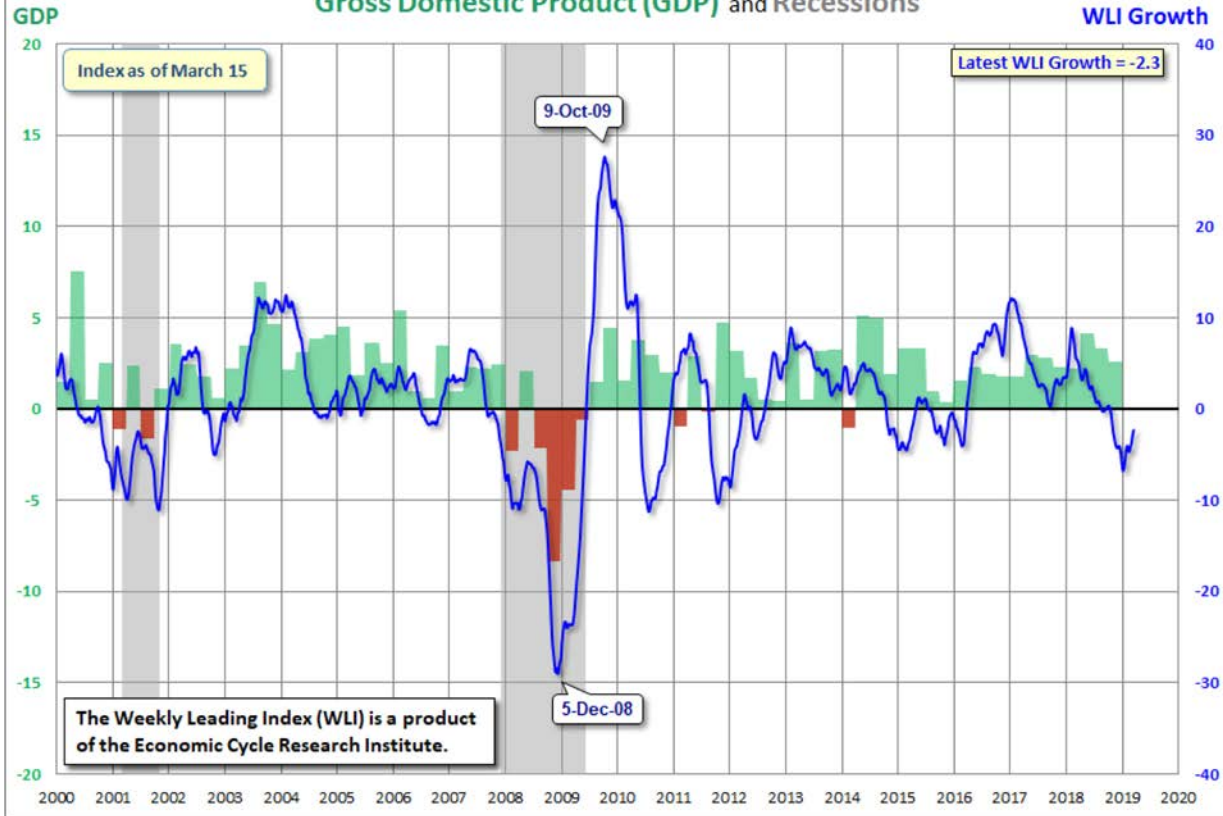


Chart 3: ECRI Weekly Leading Index is down -2.3% year over year.

ECRI Weekly Leading Index Year-over-Year of the Four-Week Moving Average

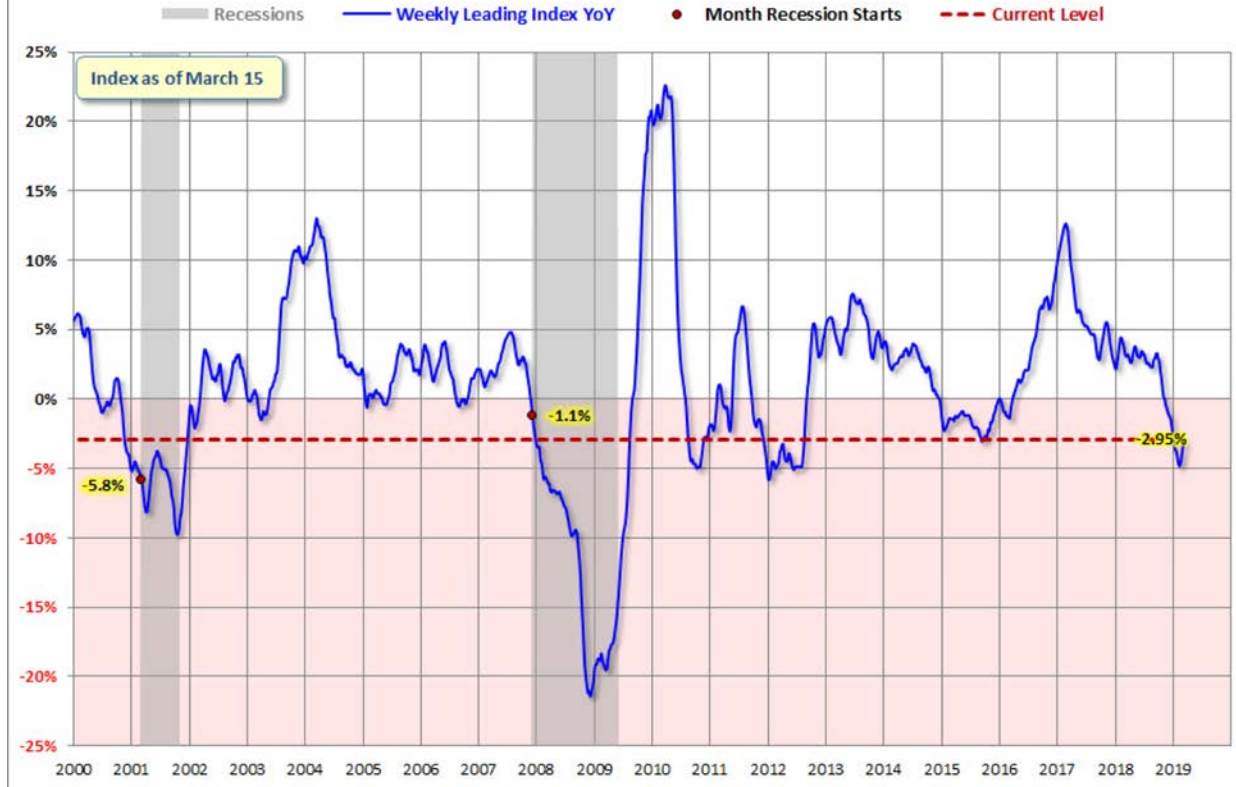


Chart 4: The four week moving average of the Weekly Leading Index is down 3.22% year over year.

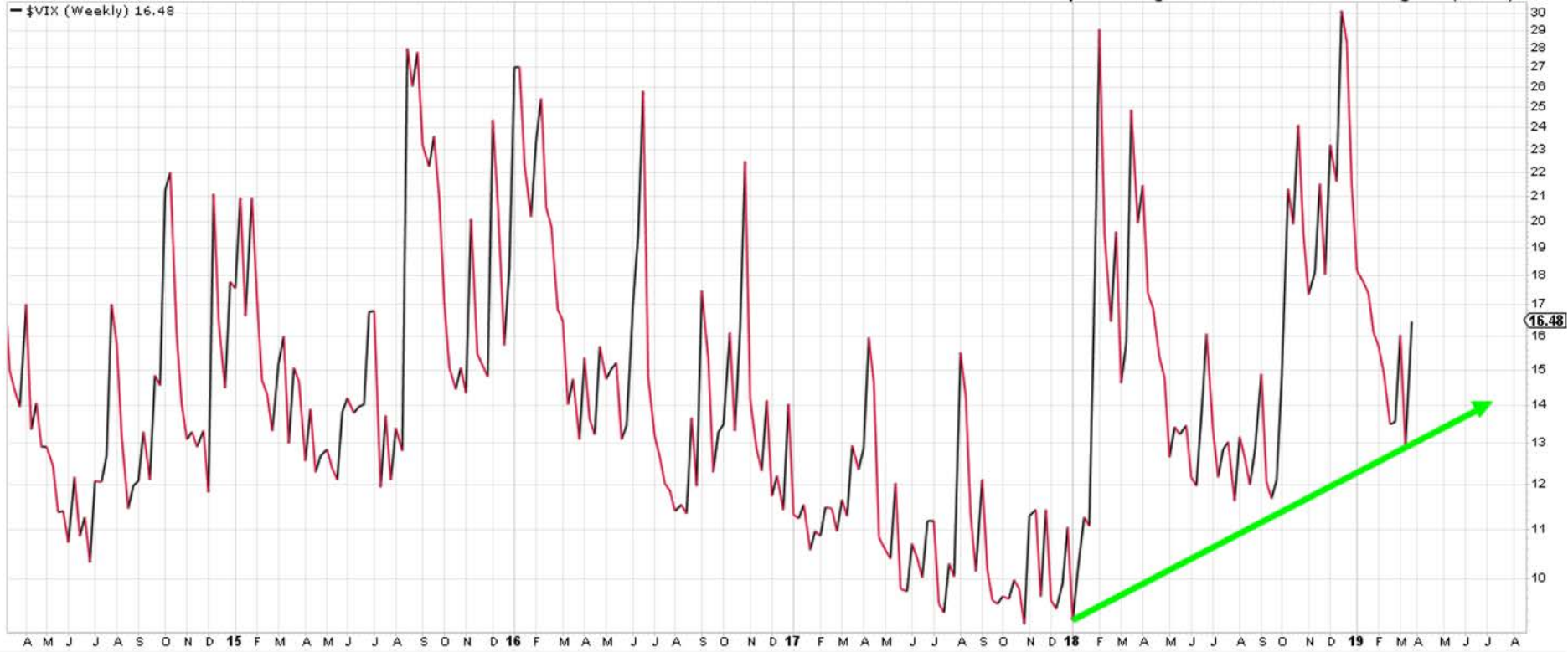


Chart 5: The VIX rallied 27.95% week over week.

\$SML:\$SPX S&P 600 Small Cap Index/S&P 500 Large Cap Index INDX

22-Mar-2019

— \$SML:\$SPX (Daily) 0.3278

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Open 0.3382 High 0.3383 Low 0.3278 Close 0.3278 Chg -0.0057 (-1.71%)



Chart 6: Small Caps have broken below December lows relative to Large Caps. This is a negative omen for the overall market.

Symbol	Name	Close	Chg	% Chg
\$VIX	\$VIX - Volatility Index - New Methodology	16.48	3.60	27.95
\$SSEC	\$SSEC - Shanghai Stock Exchange	3104.15	82.40	2.73
\$NIKK	\$NIKK - Tokyo Nikkei Average	21627.34	176.49	0.82
\$HSI	\$HSI - Hang Seng	29113.36	101.10	0.35
\$NDX	\$NDX - Nasdaq 100 Index	7326.06	19.07	0.26
\$MSEMF	\$MSEMF - Emerging Markets	1059.63	2.33	0.22
MTUM	MTUM - iShares MSCI USA Momentum Factor ETF	110.91	-0.15	-0.13
SPLV	SPLV - Invesco S&P 500 Low Volatility ETF	52.10	-0.11	-0.21
\$MSEAFE	\$MSEAFE - MSCI EAFE	1882.97	-7.34	-0.39
\$MSWORLD	\$MSWORLD - MSCI World ex USA	1880.25	-8.51	-0.45
\$SPX	\$SPX - S&P 500	2800.71	-21.77	-0.77
\$SPDAUDP	\$SPDAUDP - Dividend Aristocrats	1176.99	-10.80	-0.91
\$WLSH	\$WLSH - Wilshire 5000 Composite	28909.55	-284.20	-0.97
QUAL	QUAL - iShares Edge MSCI USA Quality Factor ETF	87.12	-0.87	-0.98
\$RUA	\$RUA-Russell 3000 Index	1649.05	-16.79	-1.01
\$INDU	\$INDU - Dow Jones Industrial Average	25502.32	-346.55	-1.34
VLUE	VLUE - Weekly Solid Line, 1280	79.06	-1.21	-1.51
\$CAC	\$CAC - French CAC 40 Index	5269.92	-135.40	-2.50
\$STRAN	\$STRAN - Dow Jones Transportation Average	10052.30	-257.82	-2.50
\$DAX	\$DAX - German DAX Composite	11364.17	-321.52	-2.75
\$RUT	\$RUT - Russell 2000 Small Cap Index	1505.92	-47.62	-3.06
IJR	IJR - Weekly Solid Line, 1280	75.33	-2.38	-3.06

EQUITY MARKET RECAP

- The Shanghai was the strongest performer, up 2.73%.
- The Wilshire 5000 was down -0.97%.
- The MSCI All World ex US was down -0.45%.
- Momentum was the strongest factor.
- Consumer discretionary was the strongest sector.
- Small caps were the weakest factor, losing 3.06%.
- The VIX rose almost 28%.
- Financials were down over -4.84%.

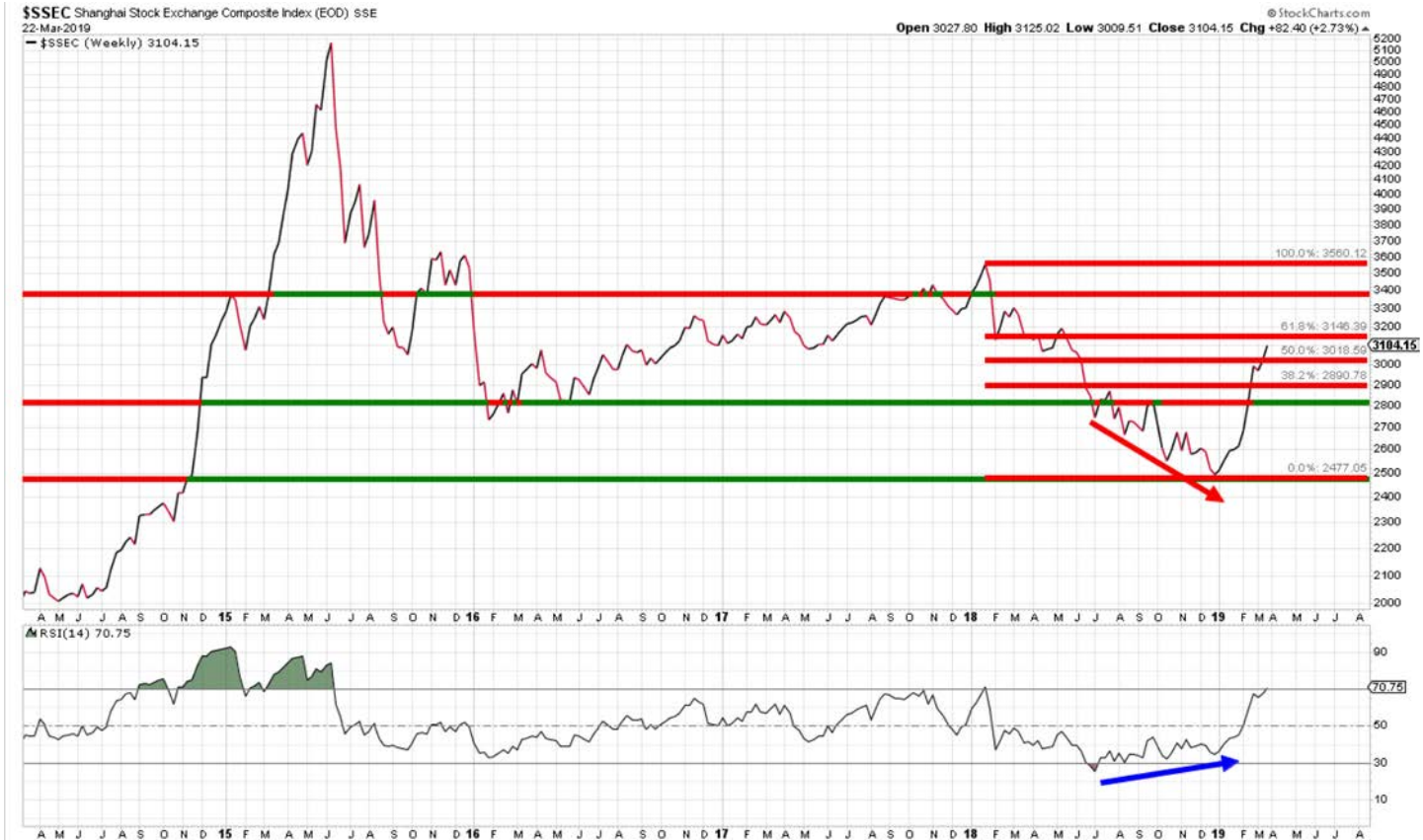


Chart 7: The Shanghai Stock Exchange was up 2.73% last week. Next resistance is at the 61.8% retracement level of 3146. It is currently at 3104.

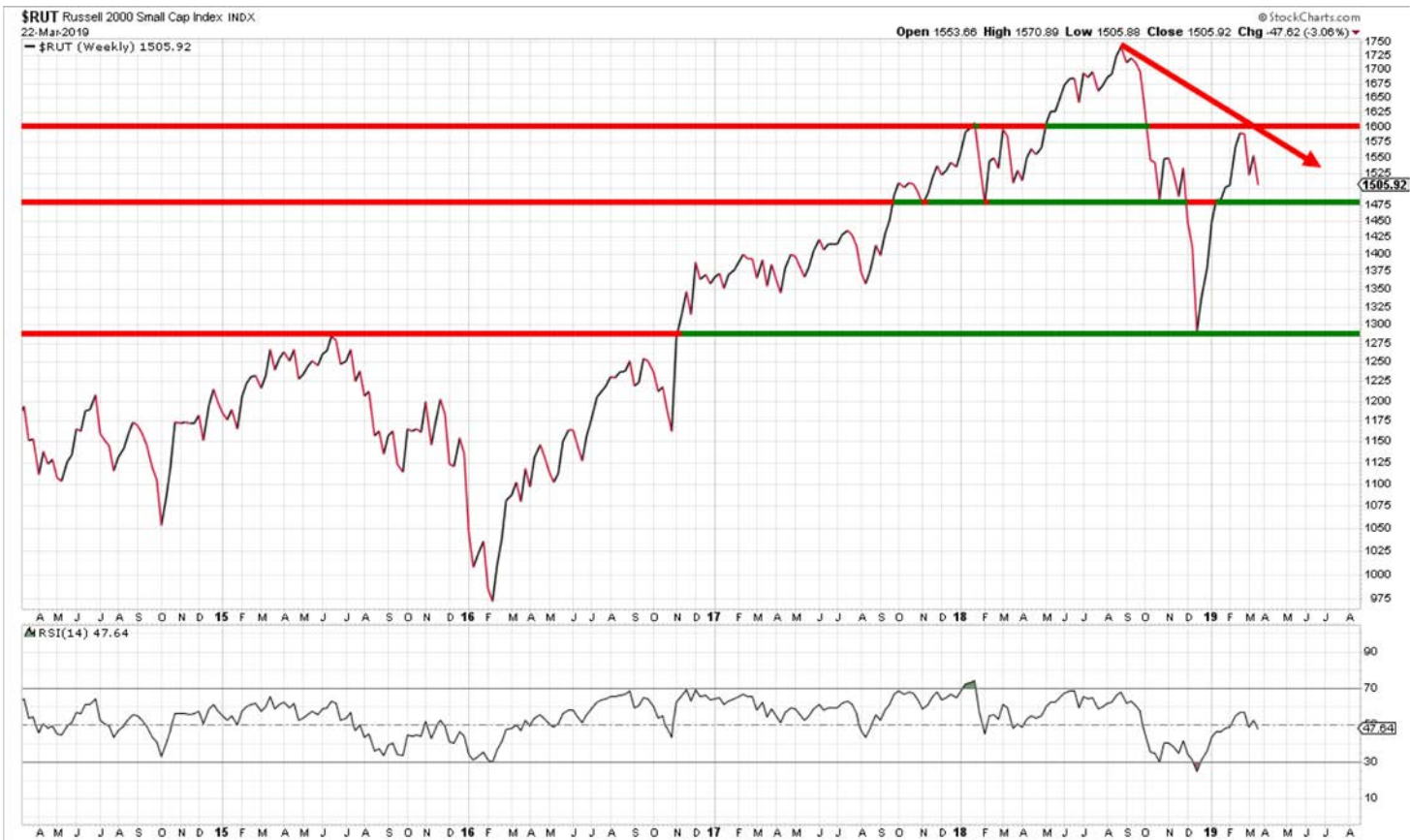


Chart 8: The Russell 2000 Small Cap Index fell -3.06% last week. It failed at resistance and is nearing support at 1475.



Chart 9: The Momentum Factor was the strongest factor, finishing the week down -0.13% for the week. Momentum has been weak over the last 6 months. Negative divergences suggest the rally could be nearing its end.

FIXED INCOME RECAP

Symbol	Name	Close	Chg	% Chg
TLT	TLT - Weekly Candlesticks, 1280	124.86	3.11	2.55
LQD	LQD - iShares iBoxx \$ Investment Grade Corporate Bond ETF	118.55	1.69	1.45
IEF	IEF - Weekly Candlesticks, 1280	106.34	1.25	1.19
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	108.62	0.92	0.85
IEI	IEI - Weekly Candlesticks, 1280	122.99	0.88	0.72
\$UST3M	\$UST3M - 3 month yield	2.46	0.01	0.41
EMB	EMB - iShares JPMorgan USD Emerging Markets Bond ETF	109.43	0.39	0.36
SHY	SHY - Weekly Candlesticks, 1280	84.03	0.23	0.27
HYG	HYG - iShares iBoxx \$ High Yield Corporate Bond ETF	85.84	0.06	0.07
\$UST30Y	\$UST30Y - 30 year yield	2.88	-0.14	-4.64
\$UST2Y	\$UST2Y - 2 year yield	2.31	-0.12	-4.94
\$UST20Y	\$UST20Y - 20 year yield	2.69	-0.14	-4.95
\$UST10Y	\$UST10Y - 10 year yield	2.44	-0.15	-5.79
\$UST5Y	\$UST5Y - 5 year yield	2.24	-0.16	-6.67
\$YC2YR	\$YC2YR - 2-10 yield curve	0.13	-0.03	-18.75
\$YC3MO	\$YC3MO - 3mo - 10yr yield curve	-0.02	-0.16	-114.29

- The 2-10 year Treasury curve dropped 3 basis points.
- The 3 mo-10 year Treasury yield curve inverted last week, dropping 16 basis points.
- The benchmark 10 year Treasury bond yield dropped 15 basis points to 2.44%.
- Long-term Treasury Bonds finished the week up 2.55%.
- The Aggregate Bond ETF (AGG) was up 0.85%
- High Yield Corporate Bonds were up 0.07%.



Chart 10: The long-term Treasury ETF (TLT) was up 2.55% last week. It also broke above the top end of the resistance zone at 124.

CURRENCY MARKET RECAP

Symbol	Name	Close	Chg	% Chg
\$NYXBT	\$NYXBT - Daily Solid Line, 1280 2	3990.74	104.43	2.69
\$JPYEUR	\$JPYEUR - Weekly Solid Line, 1280	0.81	0.01	1.64
\$JPYUSD	\$JPYUSD - Weekly Solid Line, 1280	0.91	0.01	1.38
\$USD	\$USD - US Dollar Index - Cash Settle (EOD)	96.15	0.10	0.11
\$EURUSD	\$EURUSD - Euro to US Dollar (NBD)	1.13	-0.00	-0.18
\$EURUSD	Euro to US Dollar (NBD) (\$EURUSD)	1.13	-0.00	-0.18
\$CADUSD	\$CADUSD - Canadian Dollar to US Dollar (NBD)	0.74	-0.00	-0.59
\$GBPUSD	\$GBPUSD - British Pound to US Dollar (NBD)	1.32	-0.01	-0.65
\$AUDJPY	\$AUDJPY - Australian Dollar to Japanese Yen (NBD)	77.97	-1.00	-1.27
\$USDJPY	\$USDJPY - US Dollar to Japanese Yen (EOD)	110.03	-1.47	-1.32
\$EURJPY	\$EURJPY - Euro to Japanese Yen (NBD)	124.35	-1.87	-1.48

- The NYSE Bitcoin index was up 2.69% last week.
- The US dollar was up 0.11%.
- The Euro fell -1.48% against the Yen.
- The Australian Dollar fell -1.27% against the Yen.



Chart 11: The Euro fell -1.48% against the Yen and is nearing a retest of support. This is negative for risk assets.

COMMODITIES

Symbol	Name	Close	Chg	% Chg
\$PLAT	\$PLAT - Weekly Solid Line, 1280	848.40	16.60	2.00
\$COTTON	\$COTTON - Weekly Solid Line, 1280	76.58	1.08	1.43
\$CORN	\$CORN - Weekly Solid Line, 1280	378.25	5.00	1.34
\$WTIC	\$WTIC - Crude oil	59.04	0.52	0.89
\$WHEAT	Wheat - Continuous Contract (EOD) (\$WHEAT)	466.00	3.75	0.81
\$GOLD	\$GOLD - Gold - Continuous Contract (EOD)	1312.30	9.40	0.72
\$SILVER	\$SILVER - Weekly Solid Line, 1280	15.41	0.08	0.54
\$SUGAR	\$SUGAR - Weekly Solid Line, 1280	0.13	0.00	0.40
\$CRB	\$CRB - Reuters/Jefferies CRB Index	184.15	0.29	0.16
\$BRENT	\$BRENT - Weekly Solid Line, 1280	67.03	-0.13	-0.19
\$PALL	\$PALL - Weekly Solid Line, 1280	1515.50	-3.00	-0.20
\$SOYB	\$SOYB - Weekly Solid Line, 1280	903.75	-5.50	-0.60
\$COPPER	\$COPPER - Copper - Continuous Contract (EOD)	2.84	-0.06	-2.19
\$LUMBER	\$LUMBER - Weekly Solid Line, 1280	368.30	-21.90	-5.61

- Lumber was the weakest performer last week, down -5.61%.
- Crude oil was up 0.89% for the week.
- Platinum was the strongest gainer, up 2%.
- Gold was up 0.72%.
- Copper dropped -2.19%.



Chart 12: Copper ended the week down -2.19% closing at an important support level. A continued breakdown from here could imply a negative outlook for risk assets in general.

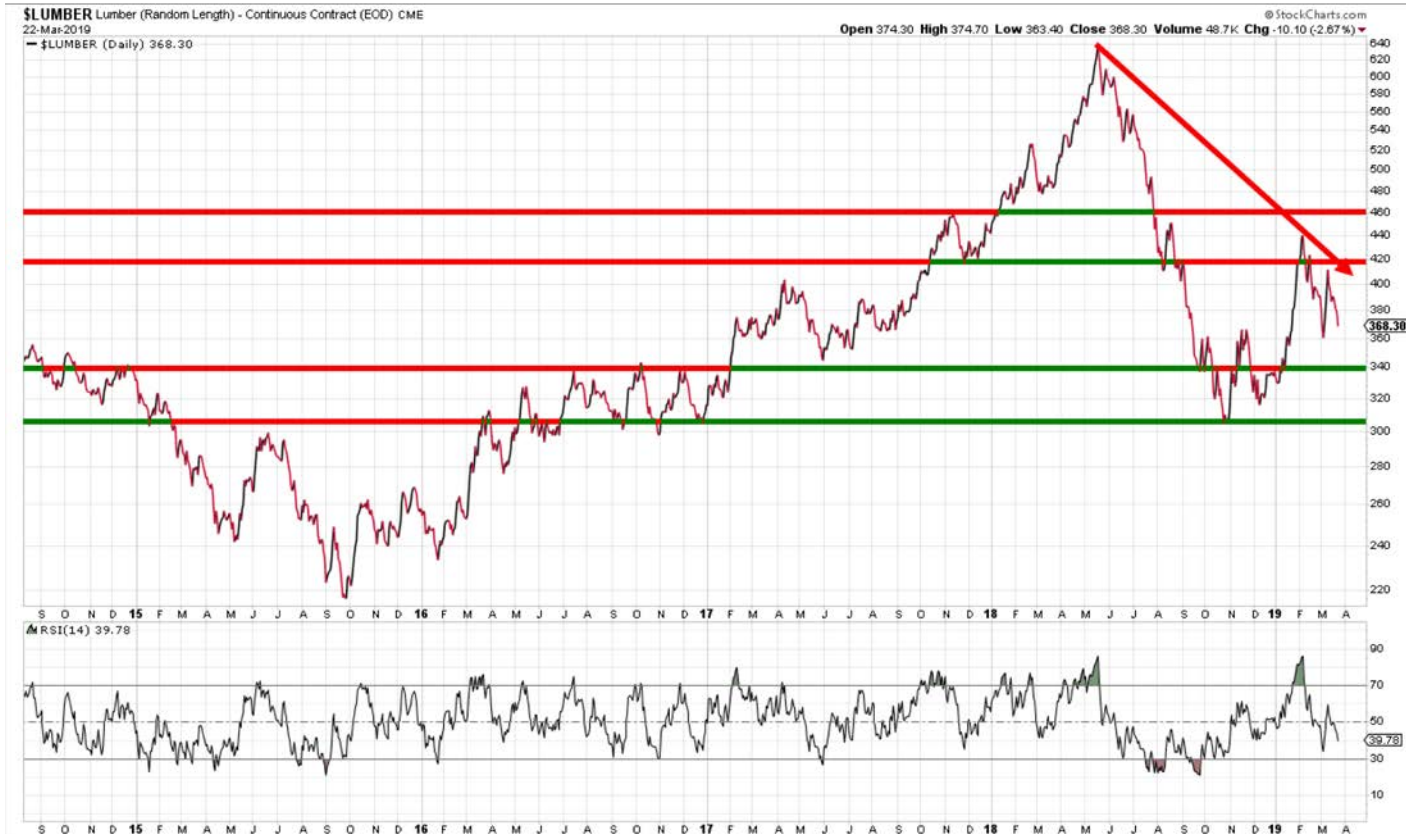


Chart 13: Lumber dropped -5.66% for the week. It is rushing toward its support range. Prior to last week it had diverged from the prices of risky assets. The breakdown in lumber prices serves as a warning of an increase in equity market volatility.

MARKET RELATIONSHIPS

Symbol	Name	Close	Chg	% Chg
\$MSEMF:\$MSEAFE	\$MSEMF:\$MSEAFE - New Favorite	0.56	0.00	0.61
MTUM:SPY	MTUM:SPY - New Favorite	0.40	0.00	0.60
SPLV:SPY	SPLV:SPY - New Favorite	0.19	0.00	0.52
VIG:SPY	VIG:SPY - New Favorite	0.39	-0.00	-0.11
\$SPDAUDP:\$SPX	\$SPDAUDP:\$SPX - Weekly Solid Line, 1280	0.42	-0.00	-0.14
\$WLSH:\$MSWORLD	\$WLSH:\$MSWORLD - New Favorite	15.38	-0.08	-0.53
SPHB:SPLV	SPHB:SPLV - Weekly Solid Line, 1280	0.79	-0.01	-0.93
TIP:TLT	TIP:TLT - New Favorite	0.90	-0.02	-1.65
\$WLSH:\$GOLD	\$WLSH:\$GOLD - New Favorite	22.03	-0.38	-1.68
\$WLSH:AGG	\$WLSH:AGG - Weekly Solid Line, 1280	266.15	-4.91	-1.81
\$SML:\$SPX	\$SML:\$SPX - Weekly Solid Line, 1280	0.33	-0.01	-2.33
JNK:TLT	JNK:TLT - New Favorite	0.29	-0.01	-2.35
\$COPPER:\$GOLD	\$COPPER:\$GOLD - New Favorite	0.00	-0.00	-2.89
\$LUMBER:\$GOLD	\$LUMBER:\$GOLD - New Favorite	0.28	-0.02	-6.29

- Stocks lost -1.81% against Bonds last week.
- Stocks lost -1.68% against Gold.
- International equities gained 0.53% against domestic stocks.
- Treasuries rallied 2.35% against High Yield Bonds.
- High Beta lost -0.93% against Low Volatility.
- Dividend Growth lost -0.14% against the S&P 500.
- Lumber lost -6.29% against Gold.



Chart 14: The Wilshire 5000 lost -1.81% against bonds last week. This relationship remains in favor of fixed income.



Chart 15: Copper fell -2.89% against gold last week. The ratio failed at resistance and is back in the middle of the range.

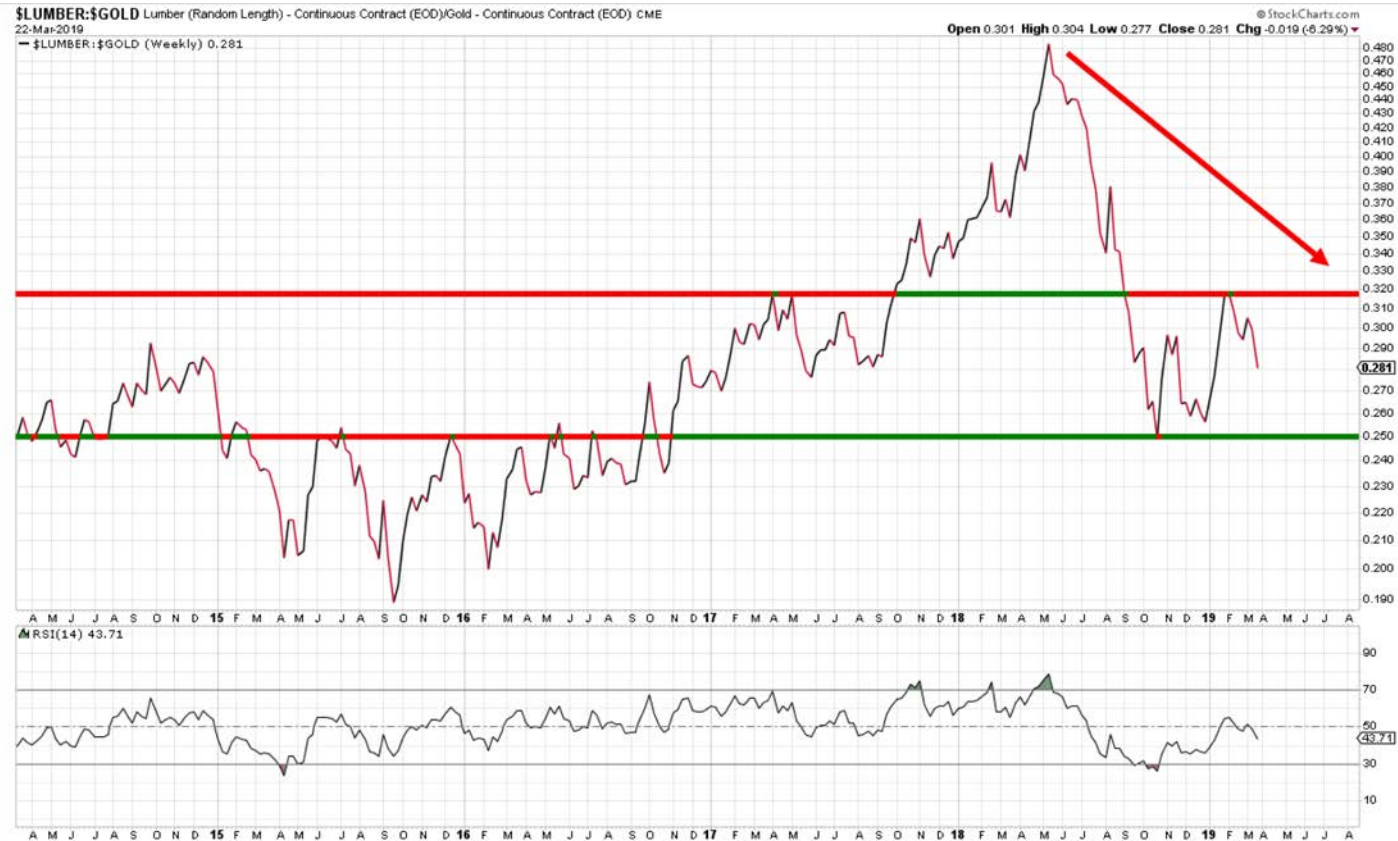


Chart 16: Lumber got crushed relative to gold last week. This ratio failed at resistance and is falling fast. Lumber led the way upward for risk assets. Over the last several weeks it has been weak relative to Gold.

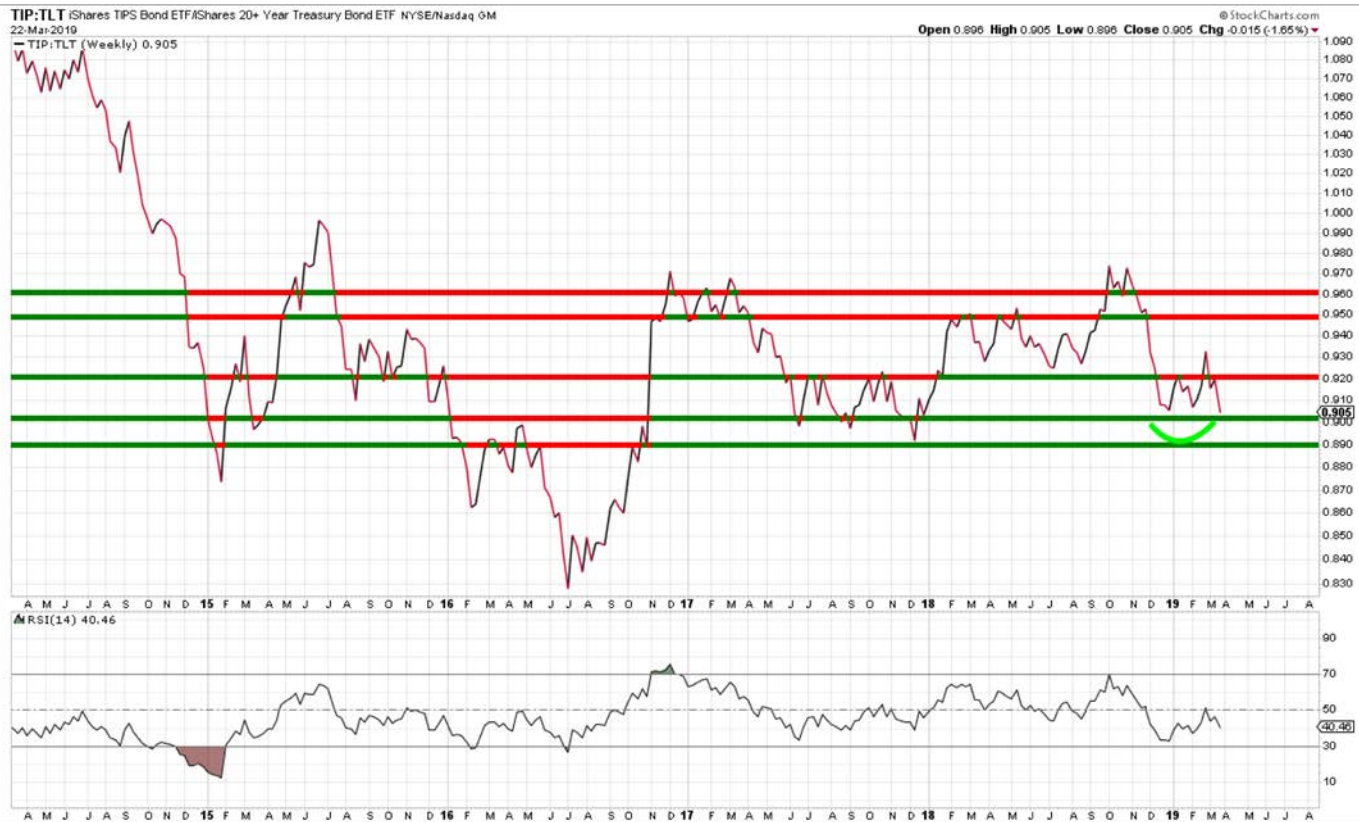


Chart 17: Tips (TIP) fell -1.65% relative to long-term Treasuries (TLT). This relationship is helpful in mapping inflation expectations. The quick reversal and false breakout suggests this relationship could test the lower support band. A breakdown would imply deflationary pressures are strong.

SUMMARY & PLAYBOOK

- Economic growth continues to slow globally and domestically.
- The ECRI Weekly Leading Index (WLI) is down -2.95% year over year.
- The 4 week average of the WLI is down -3.25% year over year.
- The Wilshire 5000 and MSCI World Ex US indexes remain in negative long-term trends relative to intermediate, risk-free bonds.
- US and Global Equities fell last week with the S&P 500 falling -0.77% and the MSCI World Ex US falling -0.45% respectively.
- Consumer discretionary was the strongest sector last week.
- Small caps were the weakest segment of the market with the Russell 2000 down over -3% for the week.
- Negative divergences remain.

Overweights:

Treasuries, Low Volatility, Utilities,
REITS, Healthcare, Dividend
Growth, High Quality

Underweights:

Credit, Momentum, Cyclical,
Growth.

DISCLOSURE

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