



Market Outlook | April 15, 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?



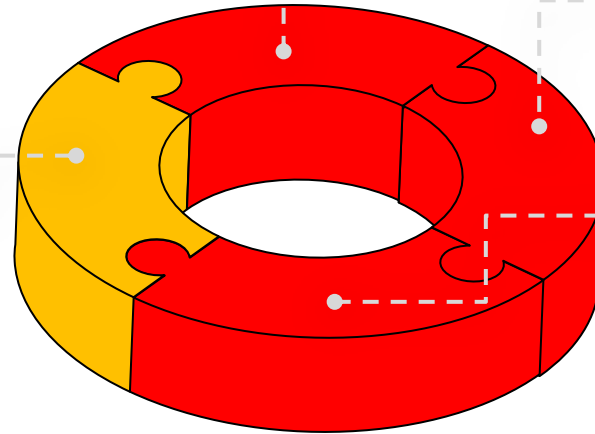
FEDERAL RESERVE ACTIVITY

Expansionary or Restrictive?



ECONOMIC ACTIVITY

Is the economy growing or shrinking?



HARD TRUTHS

“Col. Jessup : I'll answer the question!
[to Kaffee]

Col. Jessup : You want answers?

Kaffee : I think I'm entitled to.

Col. Jessep : You want answers?

Kaffee : I WANT THE TRUTH!

Col. Jessup : YOU CAN'T HANDLE THE TRUTH!

Jack Nicholson (Col. Jessup) and Tom Cruise (Kafe) in the Movie, *A Few Good Men*.



According to Investopedia, cognitive dissonance is the “unpleasant emotion that results from believing two contradictory things at the same time.” Sometimes truth is hard to handle. When truth disagrees with our beliefs or preconceptions, the mental discomfort can sometimes cause us to act irrationally to eradicate that feeling. This is common when investing. Imagine if you buy a stock that you believe will have great growth over the coming years, yet something happens to alter that growth trajectory and change the outlook. That new information is hard to adjust to; therefore, an investor may try to convince his or herself that the information is wrong or find reasons to support their beliefs.

Today is a strange time in the global economy. There are countless examples of contradictory information available. Investors are sure to be experiencing cognitive dissonance. The ways to combat cognitive dissonance are to either change the attitudes or beliefs held (hard), to acquire and incorporate new information (hard), or to convince yourself you are right (easy). In order to convince ourselves we are right, we often search out confirming evidence (*confirmation bias*) in order to support our current beliefs. *Sunk cost fallacy* makes it hard for us to incorporate new information and alter our beliefs to ease the discomfort. The effort expended on forming the beliefs in the first place makes it painful to abandon them. This is why we believe that having a system or disciplined approach to investing is the only way to invest.

HARD TRUTHS

Knowing that sunk cost fallacy, confirmation bias, and cognitive dissonance are present is the first step in preventing irrational decision making while investing. However, knowing is not enough to prevent the potential negative impact of these biases on portfolio returns. This is why a well thought out, rules-based framework is a necessity in our opinion. We know, inherently, that without a framework to rely on (one that is purely objective, measurable, repeatable, and quantitative) we would make decisions in an effort to prove ourselves right and convince ourselves that our preconceptions and beliefs are without error. This could result in poor results.

A good process would be one that takes into account new information quickly and adjusts accordingly. A simple example of this is trend following. Trend-followers rely on simple buy and sell rules and systematically take every signal, understanding that a large percentage will be wrong. The process we incorporate into our framework is also Bayesian, like pure trend-following. In other words, we take into account new information as situations evolve and this adjusts the probabilities of various outcomes. For instance, our process starts with valuations to understand the secular cycle conditions we could possibly face. If we were to use only valuations in constructing portfolios, we would have been defensive since 2015. However, we also incorporate the intermediate and short-term cycle through our measuring of market sentiment and economic growth. This information changes and often contradicts what valuations are telling us about the longer-term outlook for markets. Following a rules based system that weighs the evidence equally between the Fed, investor psychology, valuations, and economic growth helps adjust our outlook accordingly.

Since the end of October 2018, our framework has been suggesting a defensive posture. Valuations, Fed policy, market sentiment, and economic growth were all red. Since the Fed has moved dovish at the end of the year, markets have soared and economic activity has improved somewhat. If asset prices continue to remain elevated, by the end of the month the market psychology aspect of the cycle could rotate back to green. Economic growth has also improved considerably as the ECR Weekly Leading Index is now positive on a year over year basis (0.2%) as of last week. The JP Morgan Global PMI is also showing improvement, increasing two months in a row. If economic activity continues to improve, the economic growth component of our framework could also be back to green by the end of the month. We still have a couple weeks to go, but we wanted to highlight the importance of having a rules-based process that changes as the facts change. If we were not using a framework, we could selectively highlight the degradation in retail sales or the ISM non-manufacturing PMI, or we could focus only on bank stocks and the Russell 2000 to highlight the negative. This would be in an effort to prove our framework right. However our framework doesn't present opinions. It is simply a way of measuring and tracking the facts. Opinions don't matter, only the ability to rapidly adjust to new information. The focus should be on making money, not being right. We will continue to keep that at the forefront of what we do.

WEEKLY SUMMARY

Economic Activity

- Factory Orders were down -0.5% month over month. Consensus expectations were for a drop of -0.6%.
- The inflation rate jumped 0.4% month over month versus 0.2% month over month previous and expectations of a 0.3% increase.
- On a year over year basis, inflation is up 1.9% versus expectations of a 1.8% increase. This is up from 1.5% year over year the month prior.
- Producer prices gained 0.6% month over month versus an expected increase of 0.3% month over month.
- Michigan consumer sentiment (preliminary) was down to 96.9 from 98.4 previous and expectations of 98.
- The ECRI Weekly Leading Index increased to 0.2% year over year.

Equity Markets

- Dow Transports were up 1.60% last week and broke above intermediate resistance.
- The Vanguard Total World Market ETF (VT) was up 0.53% last week.
- Quality was the top performing factor, as the QUAL ETF was up 0.94%.
- China (Shanghai) was down -1.78% last week.
- Financials (XLF) were the top performing sector last week, up 2.03%.
- Market internals improved.

Fixed Income, Commodities, Currencies

- The 10 year minus 3 month Treasury curve steepened 6 basis points to 0.12%.
- The 10 year Treasury yield increased 6 basis points to 2.56%.
- The US Dollar dropped -0.43% last week to 96.07.
- Corn was the top commodity, up 1.93%. Lumber was the worst performer.

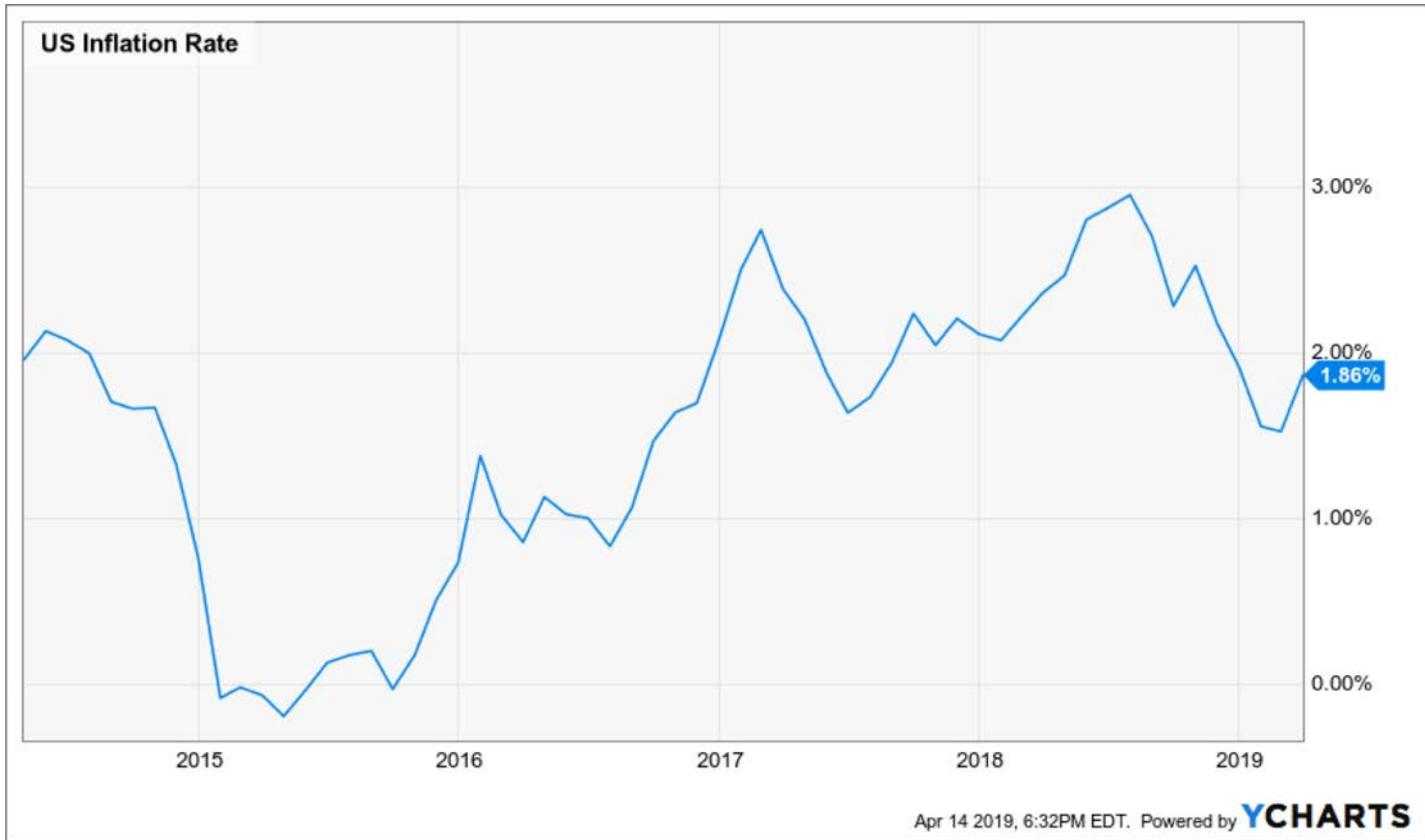


Chart 1: US inflation picked up this path month. The inflation rate is up 1.86% year over year. Inflation increased 0.4% month over month.



Chart 2: Producer prices are up 2.17% year over year. They picked up 0.6% month over month, above expectations.

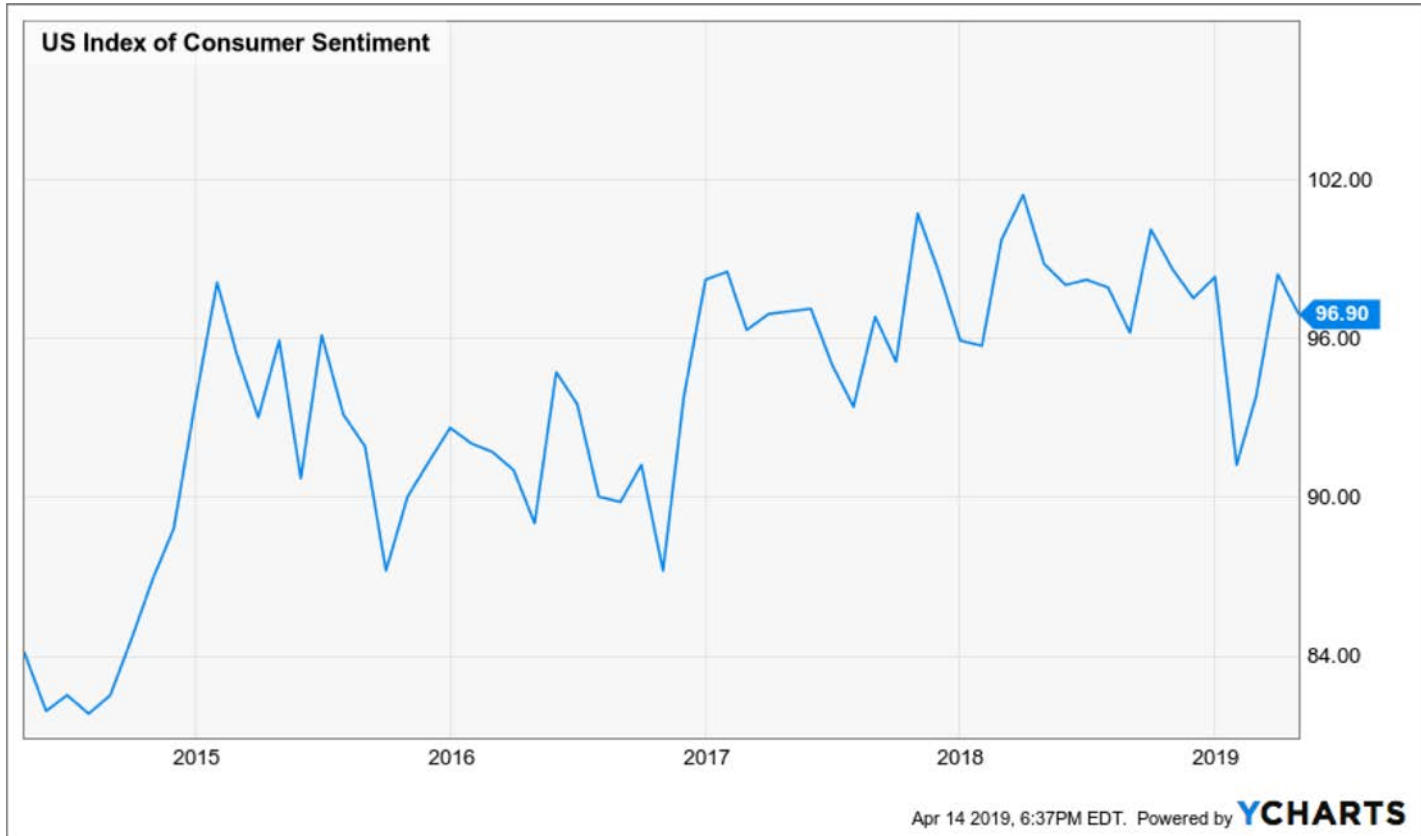


Chart 3: Michigan Consumer Sentiment dropped to 96.9 from 98.4 prior.

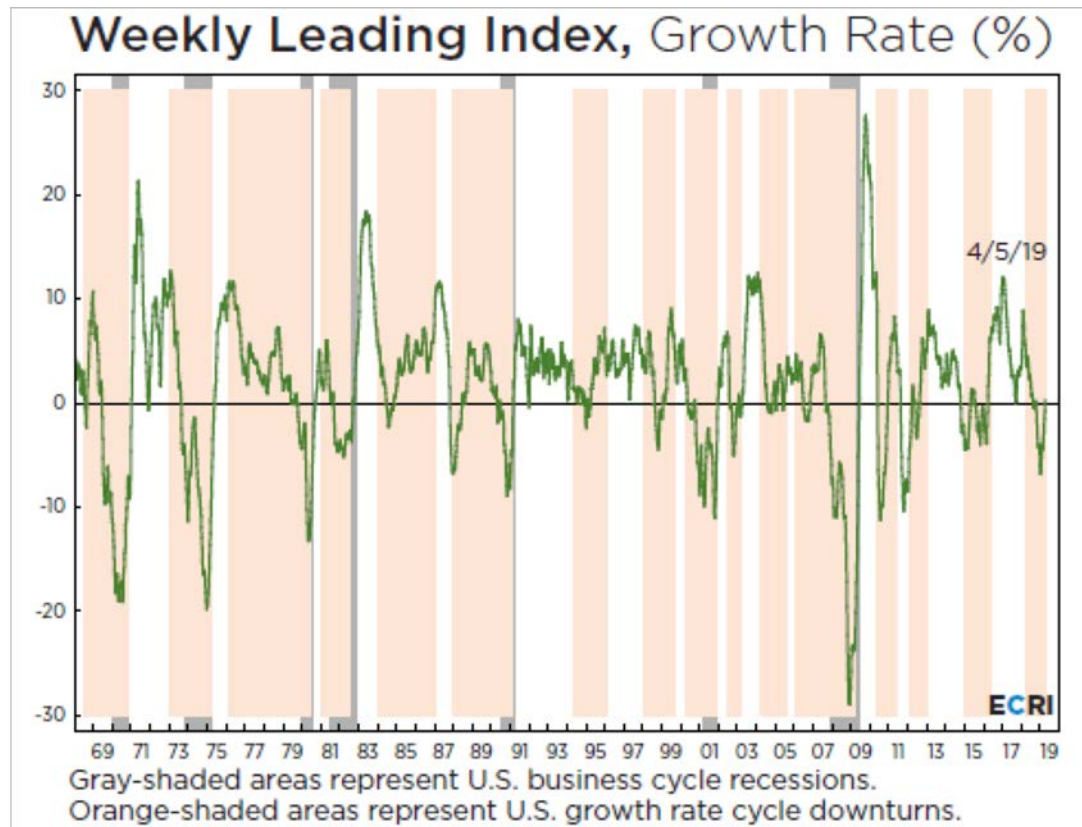


Chart 4: The ECRI weekly leading index ticked up to 0.2% year over year. This is an early sign that economic growth may be starting to accelerate. The four week moving average of the weekly leading index is still negative though, indicating that growth is slowing (but at a slower rate).



Chart 5: Dow Transports have broken above intermediate term resistance and are now in a positive trend. This confirms the move in the Dow Industrials. Will the transports break to all-time highs?

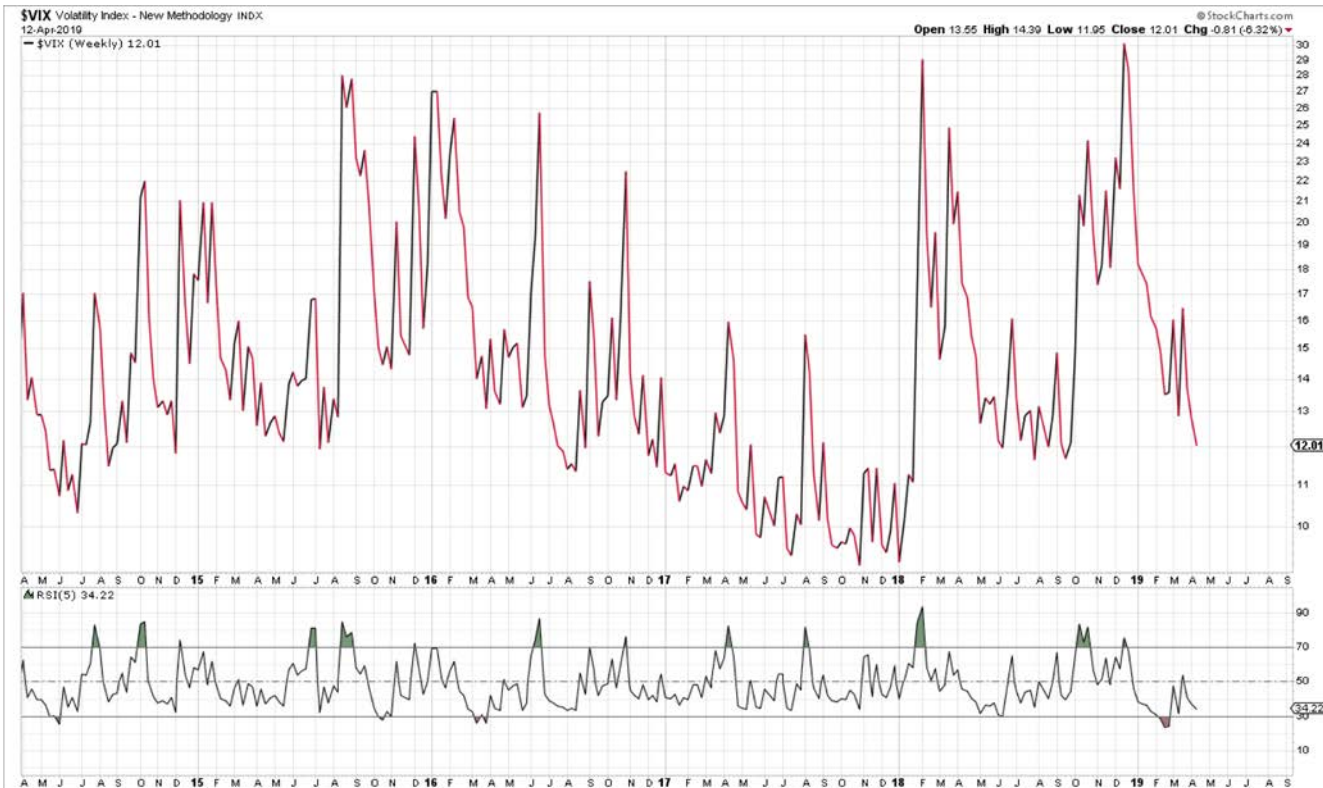


Chart 6: The \$VIX made another low last week, dropping over -6% on the week and closing just above 12. A break below the September low would imply a further breakout to the upside in equity prices. It would also signal a potential move back into a lower volatility regime. In our opinion, the only signal for caution is the divergence in momentum whereby the RSI is making high lows and higher highs despite the break down in the \$VIX.

EQUITY MARKET RECAP

Symbol	Name	Close	Chg	% Chg
\$STRAN	\$STRAN - Dow Jones Transportation Average	10912.19	177.89	1.66
\$NDX	\$NDX - Nasdaq 100 Index	7628.15	49.31	0.65
\$WLSH	\$WLSH - Wilshire 5000 Composite	30059.94	172.91	0.58
\$RUA	\$RUA-Russell 3000 Index	1715.42	9.14	0.54
VT	VT - Weekly Solid Line, 1280	75.21	0.40	0.53
\$SPX	\$SPX - S&P 500	2907.41	14.67	0.51
\$CAC	\$CAC - French CAC 40 Index	5502.70	26.50	0.48
\$MSEMF	\$MSEMF - Emerging Markets	1089.09	3.95	0.36
\$MSWORLD	\$MSWORLD - MSCI World ex USA	1915.54	5.49	0.29
\$NIKK	\$NIKK - Tokyo Nikkei Average	21870.56	63.06	0.29
\$MSEAFE	\$MSEAFE - MSCI EAFE	1915.67	4.27	0.22
\$RUT	\$RUT - Russell 2000 Small Cap Index	1584.80	2.24	0.14
\$INDU	\$INDU - Dow Jones Industrial Average	26412.30	-12.69	-0.05
\$DAX	\$DAX - German DAX Composite	11999.93	-9.82	-0.08
\$HSI	\$HSI - Hang Seng	29909.76	-26.56	-0.09
\$SSEC	\$SSEC - Shanghai Stock Exchange	3188.63	-57.94	-1.78
\$VIX	\$VIX - Volatility Index - New Methodology	12.01	-0.81	-6.32

- Transports were up 1.66% leading all indices.
- International stocks were up 0.29%.
- The VIX dropped over 6% and closed at 12.01.
- The Shanghai was down -1.78%
- The Russell 2000 lagged the S&P 500 rising 0.14% versus 0.51%.
- The Dow Jones Industrial was flat for the week, down -0.05%.



Chart 7: The Nasdaq 100 has rallied to old highs. Will it breakout to new highs this week?



Chart 8: The Vanguard Total World Market ETF is nearing all-time highs. A break above 78 would imply further upside in the global economy.



Chart 9: The French CAC 40 index rallied last week and ended at resistance and near all-time highs. Has the Europe turned the corner economically?

SECTORS

Symbol	Name	Close	Chg	% Chg
XLF	XLF - Financial Select Sector SPDR Fund	27.14	0.54	2.03
XLC	XLC - Weekly Solid Line, 1280	49.02	0.70	1.45
XLK	XLK - Technology Select Sector SPDR Fund	76.81	0.89	1.17
XLP	XLP - Consumer Staples Select Sector SPDR Fund	56.20	0.61	1.10
FDN	FDN - First Trust Dow Jones Internet Index Fund	143.40	0.97	0.68
XLY	XLY - Consumer Discretionary Select Sector SPDR Fund	118.32	0.80	0.68
XLB	XLB - Materials Select Sector SPDR Fund	58.12	0.30	0.52
XLRE	XLRE - Weekly Solid Line, 1280	36.70	0.15	0.41
XLI	XLI - Industrial Select Sector SPDR Fund	77.28	0.27	0.35
XLU	XLU - Utilities Select Sector SPDR Fund	58.21	0.11	0.19
XLE	XLE - Energy Select Sector SPDR Fund 2	67.56	-0.05	-0.07
XLV	XLV - Health Care Select Sector SPDR Fund	89.81	-2.19	-2.38
XBI	XBI - Weekly Solid Line, 1280	89.90	-3.90	-4.16

- Financials were the top performing sector, up 2.03% for the week.
- Healthcare was the worst performing broad sector, down -2.38%.
- Biotechnology was down -4.16%.
- Energy dropped -0.07% despite the rally in oil.



Chart 10: Financials rallied over 2% last week on JP Morgan beating expectations and interest rates moving upward.

FACTORS

Symbol	Name	Close	Chg	% Chg
SPHB	SPHB - Weekly Solid Line, 1280	43.97	0.63	1.45
SPHB:SPLV	SPHB:SPLV - Weekly Solid Line, 1280	0.83	0.01	0.98
QUAL	QUAL - iShares Edge MSCI USA Quality Factor ETF	91.16	0.85	0.94
VIG	VIG - Vanguard Dividend Appreciation ETF	111.78	0.96	0.87
IWD	IWD - iShares Russell 1000 Value ETF	126.57	0.80	0.64
IWF	IWF - iShares Russell 1000 Growth ETF	155.78	0.91	0.59
SPLV	SPLV - Invesco S&P 500 Low Volatility ETF	53.19	0.25	0.47
VYM	VYM - Vanguard High Dividend Yield ETF	87.49	0.40	0.46
IJR	IJR - iShares Core S&P Small-Cap ETF	79.69	0.34	0.43
USMV	USMV - iShares Edge MSCI Minimum Volatility USA ETF	59.43	0.20	0.34
VIG:SPY	VIG:SPY - Weekly Solid Line, 1280	0.39	0.00	0.31
MTUM	MTUM - iShares MSCI USA Momentum Factor ETF	112.79	0.26	0.23
VLUE	VLUE - Daily Solid Line, 1280	82.38	0.07	0.09
IWD:IWF	iShares Russell 1000 Value ETF/iShares Russell 1000 Growth ETF (IWD:IWF)	0.81	0.00	0.05
SPLV:SPY	Invesco S&P 500 Low Volatility ETF/SPDR S&P 500 ETF (SPLV:SPY)	0.18	-0.00	-0.08
VYM:SPY	VYM:SPY - Weekly Solid Line, 1280	0.30	-0.00	-0.09
IJR:SPY	iShares Core S&P Small-Cap ETF/SPDR S&P 500 ETF (IJR:SPY)	0.27	-0.00	-0.12
MTUM:SPY	iShares MSCI USA Momentum Factor ETF/SPDR S&P 500 ETF (MTUM:SPY)	0.39	-0.00	-0.32
VLUE:SPY	VLUE:SPY - Daily Solid Line, 1280	0.28	-0.00	-0.46

- Quality was the strongest factor last week, gaining 0.94%.
- Value was the weakest factor, gaining 0.09%.
- High Beta stocks (not a factor) rallied 1.45% and 0.98% against Low Volatility.
- Dividend growth (VIG) rallied 0.87%.



Chart 11: Dividend Growth (MIG), which expresses low volatility, high quality, and value in a multi factor combination, rallied 0.87% last week and broke to new all-time highs.

FIXED INCOME RECAP

Symbol	Name	Close	Chg	% Chg
\$YC3MO	\$YC3MO - 3mo - 10yr yield curve	0.12	0.06	100.00
\$YC2YR	\$YC2YR - 2-10 yield curve	0.16	0.01	6.67
\$UST5Y	\$UST5Y - 5 year yield	2.38	0.07	3.03
\$UST10Y	\$UST10Y - Weekly Solid Line, 1280	2.56	0.06	2.40
\$UST20Y	\$UST20Y - 20 year yield	2.78	0.06	2.21
\$UST2Y	\$UST2Y - 2 year yield	2.40	0.05	2.13
\$UST30Y	\$UST30Y - 30 year yield	2.97	0.06	2.06
HYG	HYG - iShares iBoxx \$ High Yield Corporate Bond ETF	86.96	0.53	0.61
LQD	LQD - iShares iBoxx \$ Investment Grade Corporate Bond ETF	119.02	0.47	0.40
\$UST3M	\$UST3M - 3 month yield	2.44	0.00	0.00
SHY	SHY - Weekly Candlesticks, 1280	83.84	-0.04	-0.05
AGG	AGG - iShares Core U.S. Aggregate Bond ETF	108.27	-0.12	-0.11
IEI	IEI - Weekly Candlesticks, 1280	122.25	-0.33	-0.27
IEF	IEF - Weekly Candlesticks, 1280	105.27	-0.46	-0.44
EMB	EMB - iShares JPMorgan USD Emerging Markets Bond ETF	109.46	-0.56	-0.51
TLT	TLT - Weekly Candlesticks, 1280	122.67	-1.36	-1.10

- The 3 mo-10 year Treasury yield curve moved up from 6 basis points to 12 basis points.
- The benchmark 10 year Treasury bond yield rose 6 basis points to 2.56%.
- High Yield bonds were the top performing segment of fixed income, up 0.61%.
- The Aggregate Bond ETF (AGG) was down -0.11%.
- Long-term Treasury bonds were down -1.10%.
- Emerging Market Bonds (EMB) were down -0.53%..



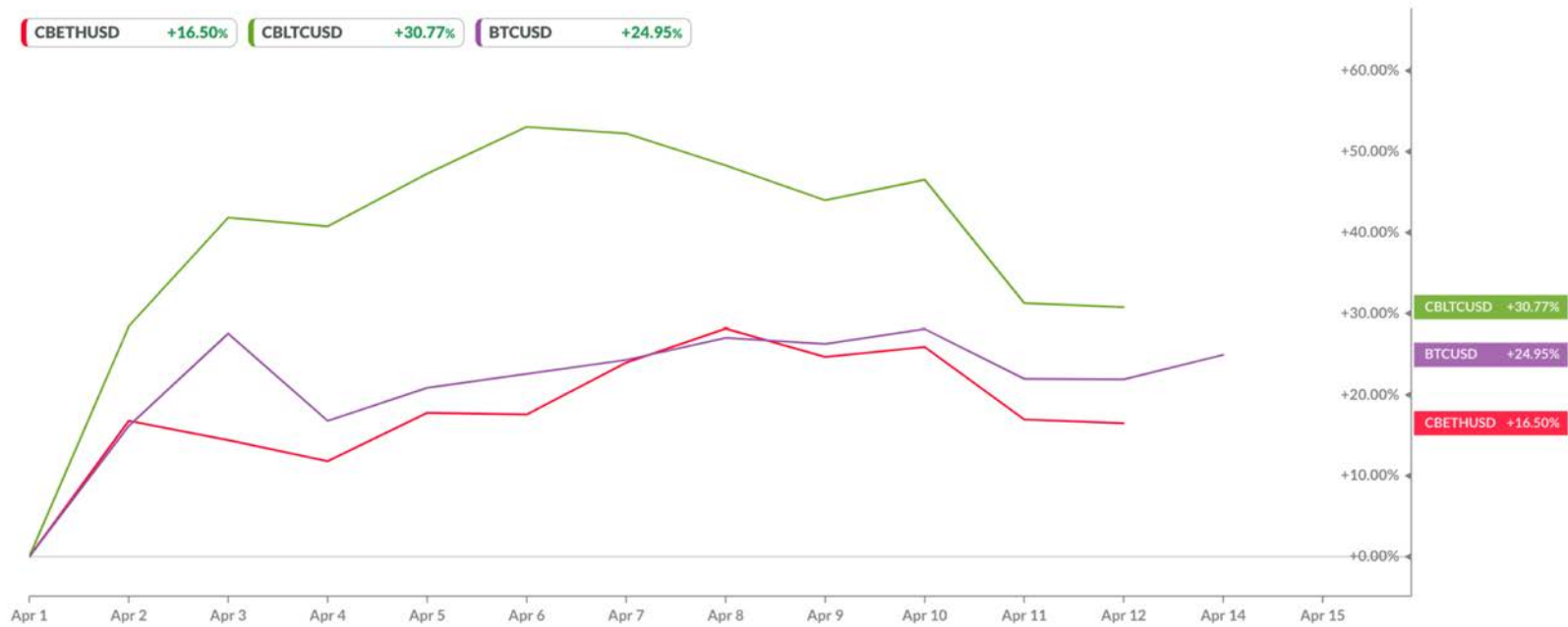
Chart 12: Long Term Treasury bonds (TLT) fell back into the resistance zone. If TLT breaks back into the long-term range, it would be negative for bonds.

CURRENCY MARKET RECAP

Symbol	Name	Close	Chg	% Chg
\$NYXBT	\$NYXBT - Daily Solid Line, 1280 2	5070.49	82.68	1.66
\$AUDJPY	\$AUDJPY - Weekly Solid Line, 1280	80.32	0.96	1.21
\$EURJPY	\$EURJPY - Euro to Japanese Yen (NBD)	126.51	1.22	0.98
\$EURUSD	\$EURUSD - Euro to US Dollar (NBD)	1.13	0.01	0.70
\$CADUSD	\$CADUSD - Canadian Dollar to US Dollar (NBD)	0.75	0.00	0.43
\$GBPUSD	\$GBPUSD - British Pound to US Dollar (NBD)	1.31	0.00	0.32
\$USDJPY	\$USDJPY - US Dollar to Japanese Yen (EOD)	112.00	0.30	0.27
\$JPYUSD	\$JPYUSD - Weekly Solid Line, 1280	0.89	-0.00	-0.29
\$USD	\$USD - US Dollar Index - Cash Settle (EOD)	96.07	-0.41	-0.43
\$JPYEUR	\$JPYEUR - Weekly Solid Line, 1280	0.79	-0.01	-1.00

- The NYSE Bitcoin index was up 1.66%
- The Australian Dollar was up 1.21% against the Yen.
- The Euro rallied 0.98% against the Yen.
- The US Dollar was down -0.43%.

CBETHUSD +16.50% CBLTCUSD +30.77% BTCUSD +24.95%



Created using KOYFIN

Chart 13: Bitcoin crossed above its 34 week moving average last week as it surged to over 5000. It is up over 40% this year.



Chart 14: The US Dollar fell -0.43% last week against a basket of currencies. It is still in a positive trend; however, it is consolidating below important resistance at 97.

COMMODITIES

Symbol	Name	Close	Chg	% Chg
\$CORN	\$CORN - Weekly Solid Line, 1280	369.50	7.00	1.93
\$COPPER	\$COPPER - Copper - Continuous Contract (EOD)	2.95	0.05	1.78
\$BRENT	\$BRENT - Weekly Solid Line, 1280	71.55	1.21	1.72
\$WTIC	\$WTIC - Crude oil	63.89	0.81	1.28
\$SUGAR	\$SUGAR - Weekly Solid Line, 1280	0.13	0.00	1.25
\$COTTON	\$COTTON - Weekly Solid Line, 1280	78.86	0.61	0.78
\$CRB	\$CRB - Reuters/Jefferies CRB Index	188.36	0.68	0.36
\$PALL	\$PALL - Weekly Solid Line, 1280	1350.20	4.30	0.32
\$GOLD	\$GOLD - Gold - Continuous Contract (EOD)	1295.20	-0.40	-0.03
\$SOYB	\$SOYB - Weekly Solid Line, 1280	895.25	-3.75	-0.42
\$WHEAT	Wheat - Continuous Contract (EOD) (\$WHEAT)	464.50	-3.25	-0.69
\$PLAT	\$PLAT - Weekly Solid Line, 1280	898.50	-6.90	-0.76
\$SILVER	\$SILVER - Weekly Solid Line, 1280	14.96	-0.12	-0.82
\$LUMBER	\$LUMBER - Weekly Solid Line, 1280	348.70	-4.10	-1.16

- Corn rallied 1.93% last week.
- Copper was up 1.78% last week and closed at resistance.
- West Texas Crude was up 1.28%.
- Gold was flat on the week, down -0.03%.
- Lumber was down another -1.16%.



Chart 15: Corn rallied 1.93% last week and was the top performing commodity. Corn remains in a long-term range.



Chart 16: Copper rallied 1.78% last week. It is still diverging negative from stock prices, but is close to breaking to new short-term highs. That would confirm the market move. This week is critical for Copper.

MARKET SENTIMENT

Symbol	Name	Close	Chg	% Chg
\$COPPER:\$GOLD	\$COPPER:\$GOLD - New Favorite	0.00	0.00	1.81
JNK:TLT	JNK:TLT - New Favorite	0.30	0.01	1.81
TIP:TLT	TIP:TLT - New Favorite	0.92	0.01	1.05
VT:IEF	VT:IEF - Weekly Solid Line, 1280	0.71	0.01	0.97
\$WLSH:\$GOLD	\$WLSH:\$GOLD - New Favorite	23.21	0.14	0.61
\$WLSH:\$MSWORLD	\$WLSH:\$MSWORLD - New Favorite	15.69	0.05	0.29
\$MSEMF:\$MSEAFE	\$MSEMF:\$MSEAFE - New Favorite	0.57	0.00	0.14
\$SPDAUDP:\$SPX	\$SPDAUDP:\$SPX - Weekly Solid Line, 1280	0.42	-0.00	-0.56
\$LUMBER:\$GOLD	\$LUMBER:\$GOLD - New Favorite	0.27	-0.00	-1.13

- Copper/Gold rallied 1.81% last week.
- High Yield spreads compressed to 3.79%, down 7 basis points.
- Global stocks rallied against bonds as VT rose 0.97% against Treasuries (IEF).
- High yield bonds rallied 1.81% against long-term Treasuries (JNK/TLT).
- Tips (TIP) gained 1.05% against long-term Treasuries
- Lumber dropped -1.13% against Gold.



Chart 17: The Vanguard Total World Stock Market Index Fund (VT) rallied against Bonds last week (IEF). Stocks are nearing a positive trend against bonds on an intermediate-term basis. The VT/IEF ratio ended the week at resistance. A break above would confirm the recent move higher in equity prices.



Chart 18: Small Caps fell against large caps last week (IJR:SPY). This is one of the most notable negative divergences in the market currently.



Chart 19: Lumber dropped another -1.13% against Gold last week. The ratio is negative and implies an increase in future volatility.



Chart 20: The Wilshire 5000 rallied against Gold last week, gaining 0.61%. US stocks are in a positive trend relative to gold over the intermediate term.

SUMMARY & PLAYBOOK

Confirming Evidence of a continued rally:

- The ECRI Weekly Leading Index (WLI) picked up again last week and continues to rebound. It is now positive year over year.
- Stocks rallied to new short-term highs against bonds.
- US stocks are in a positive trend relative to Gold (intermediate).
- The Yen and the Dollar weakened last week.
- The VIX made a short-term low.
- Transports broke above resistance.

Non-Confirming evidence of a continued rally:

- The ECRI four week average is still negative year over year.
- The Total World Stock Market remains in a negative trend relative to bonds (intermediate).
- Lumber has been weak and is continuing to drop significantly.
- Small Caps are below their December low relative to Large Caps.
- Copper failed to break to new short-term highs.
- Treasury yields remain in a strong negative trend.
- The Dollar remains in a positive trend.
- Quality remains a strong factor.

Overweights:

Treasuries, Low Volatility, Utilities,
REITS, Technology, Dividend
Growth, High Quality, EM

Underweights:

Credit, Momentum, Cyclicals,
Small Caps, Developed

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