



Market Outlook | February 19, 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?



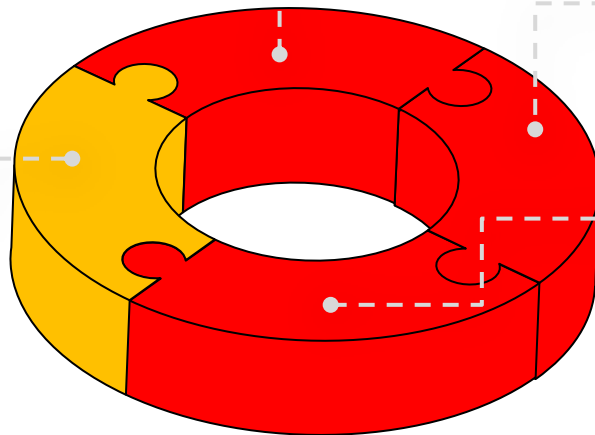
## FEDERAL RESERVE ACTIVITY

Expansionary or Restrictive?



## ECONOMIC ACTIVITY

Is the economy growing or shrinking?



# HOPE

Since the Federal Reserve tilted Dovish to the weakening growth and inflation data, the US stock market has rallied more than 15%. From a technical perspective we rallied from deep oversold conditions, where less than 2% of the companies in the S&P 500 were trading above their 50 day moving averages. Currently that number is over 90%, which is one of the most overbought conditions in the indicator's history.

What we find unnerving about this particular rally is the fact that it has occurred as data has deteriorated. Economic growth has continued to slow both in the US and globally. Last week we saw one of the steepest month over month drops in retail sales in the US. We also saw industrial production contract. At the same time, Italy is in a recession and Germany looks to be quickly approaching one as well. Nevertheless, the rally in global stocks continues.

It is our opinion that we have entered the danger zone. It is not just stocks that have rallied since December. Everything is up. US stocks, International Equities, Treasuries, the US Dollar, Commodities, and Gold are all up. In our opinion, this cannot last forever. Something has to give. Either the Fed's move will reignite economic growth and the data will catch up to the stock market, or the stock market will catch down to the data. If economic growth starts to accelerate, we would expect the Dollar, Treasuries, and Gold to fall. The days of all asset classes moving up in unison are probably numbered.

We think that the more probable outcome is that economic growth will continue to slow. This would bode well for Treasuries, Gold, and defensive equities. If the data changes, we will change our opinion. Until then, we will maintain that being defensively positioned is best for this point in the cycle.

The rally in stocks has been largely driven by hope. Hope that the Fed will save the day. Hope that the ECB will stop economic inertia and prevent a recession through more stimulus. Hope that a trade deal between the US and China can cause growth to accelerate. Hope, however, is not part of our investment management process. If these hopes turn to reality and are reflected in the data, then we will change our minds. Until then, we will stick with our process.

# WEEKLY SUMMARY

Economic growth and inflation data demonstrated the slowing trend that started in the fourth quarter of 2018. The big data points for the week were retail sales and industrial production. Retail sales were down -1.2% month over month for December. This was a surprise contraction in retail sales as expectations were set for a 0.2% increase month over month. It was the steepest decline since September 2009. Industrial production also dropped more than expected, falling -0.6% month over month. The expectation was for an increase of 0.1% for the month.

The ECRI Weekly Leading Index dropped 0.7 week over week. The year over year growth rate is now at -4.3%, down from 4% a week prior. The year over year percentage change of the four week moving average now stands at -4.75%. Economic growth appears to be continuing to slow in the US.

The Vanguard Total Global Stock market ETF (VT) rallied 2.36% last week. This particular index fund closed above key resistance, a positive sign for risk assets in general. The VT index fund covers approximately 98% of the global investable market cap.

Long-term Treasuries dropped 0.21% (CBOT US 30 Year Treasury Bond Price). Gold gained 0.27% on the week, closing at 1322.10 for the week. The CRB commodities index finished up 1.85% for the week, despite CPI and PPI data demonstrating a slowdown in inflation.

The broader stock market had an impressive risk-on rally last week as defensive sectors, factors, and asset classes lost ground to offensive ones. The S&P 500 closed the week above the 200 day simple moving average and looks set to test the 2800 resistance level. Our long-term volatility range for the S&P 500 is now 2518-2817, implying upside of 1.5% versus downside of almost -10%.

\$SPXA50R S&P 500 Percent of Stocks Above 50 Day Moving Average (EOD) INDX

15-Feb-2019

— \$SPXA50R (Daily) 92.20

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Open 92.20 High 92.20 Low 92.20 Close 92.20 Chg +2.80 (+3.13%) ▲

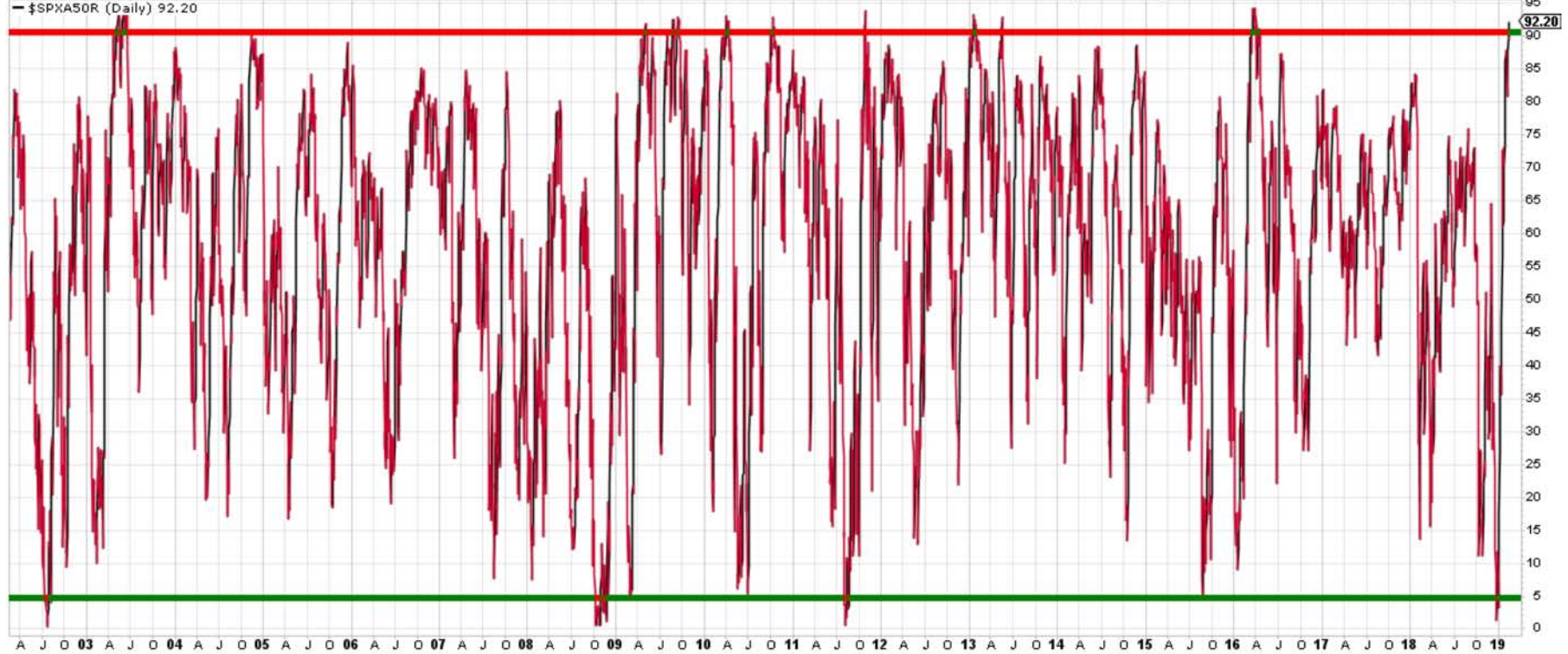


Chart 1: Over 90% of stocks in the S&P 500 are above their 50 day moving averages. This indicator continues to flash an overbought warning. It also speaks to the impressive breadth of the rally since the oversold lows in December.



Chart 2: Stocks, bonds, gold, commodities, and the US dollar are all up since the December 24th lows.

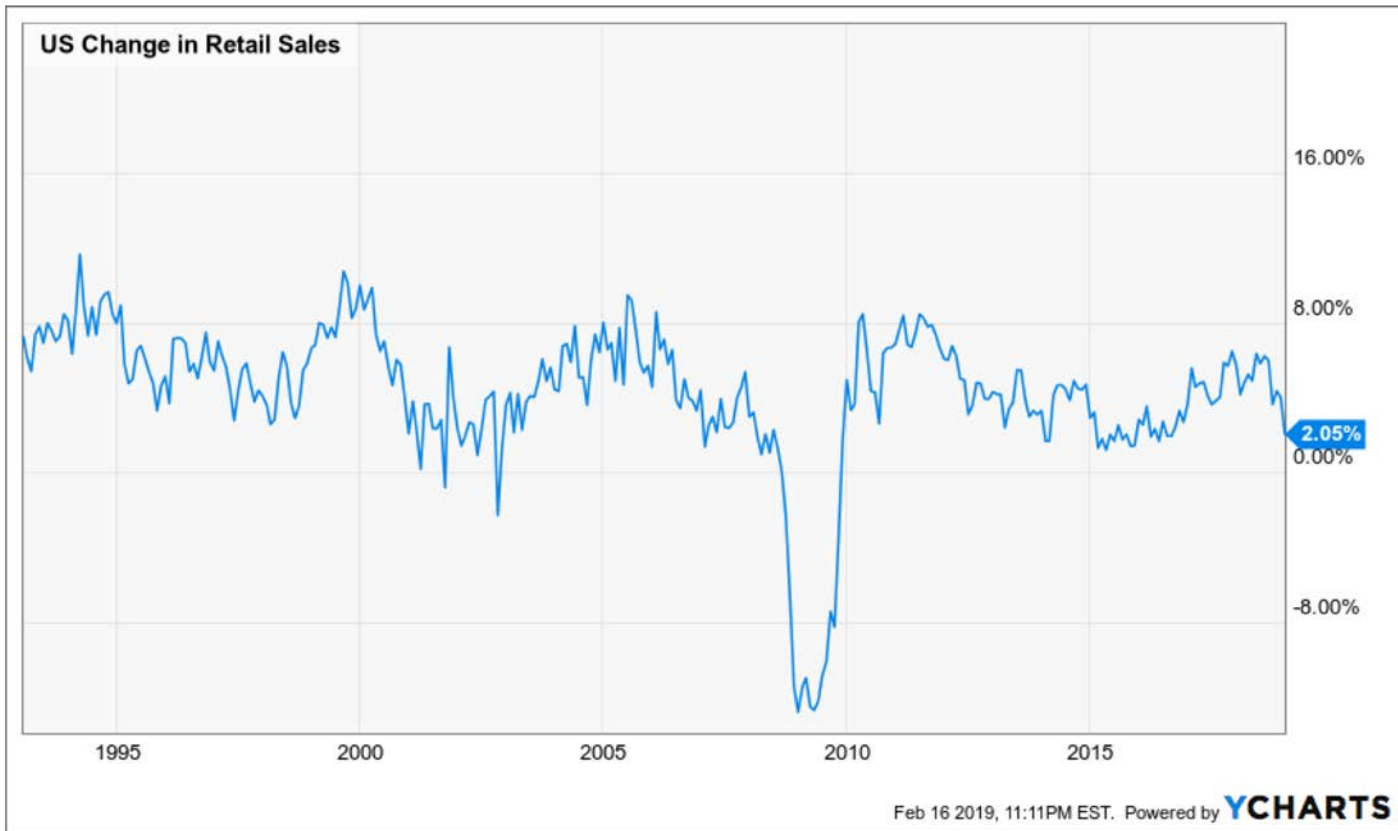


Chart 3: Retail sales slowed considerably in the month of December. They contracted -1.2% month over month. Retail activity has now slowed to a growth rate of 2% year over year.

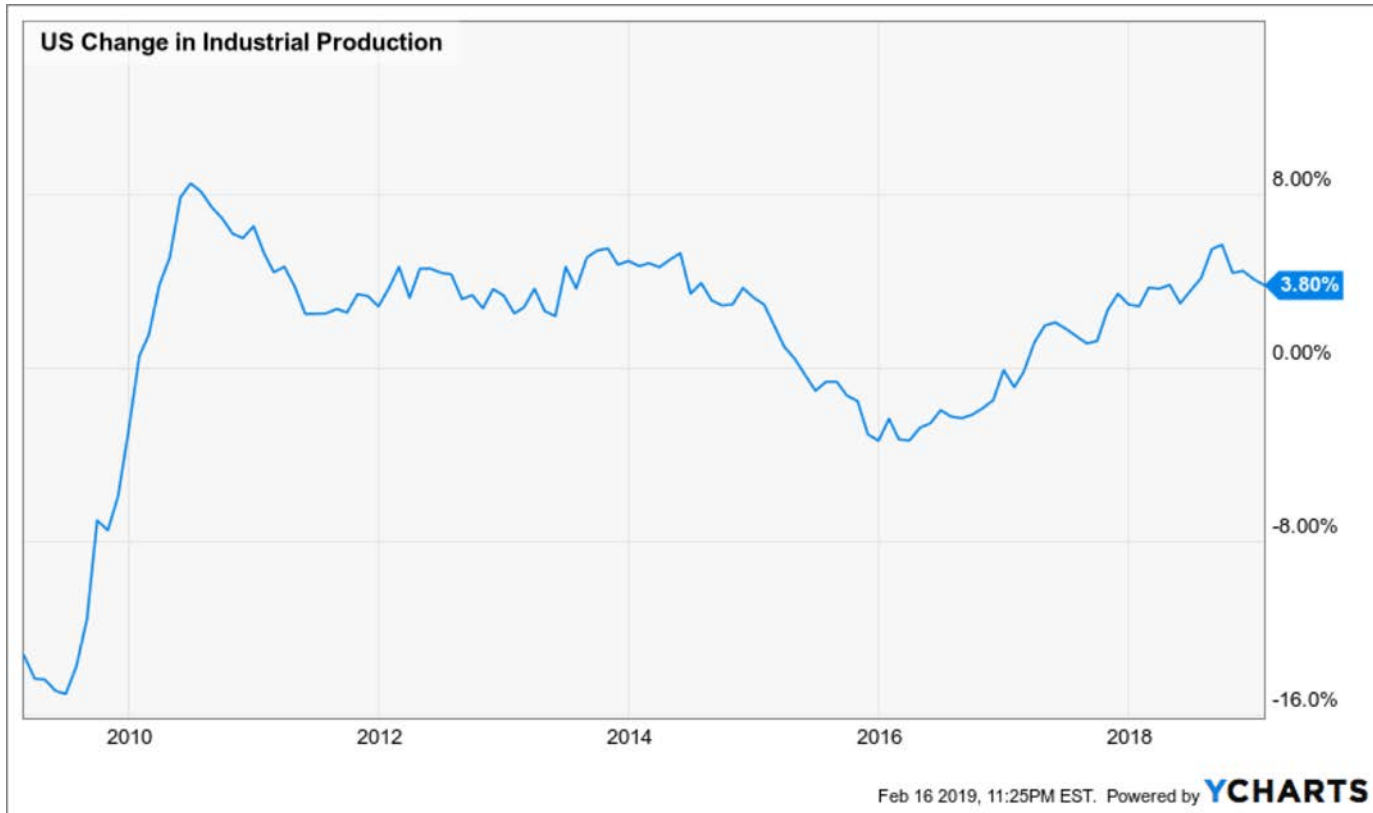


Chart 4: Industrial production slowed as well. It had a surprise drop of -0.6% month over month.



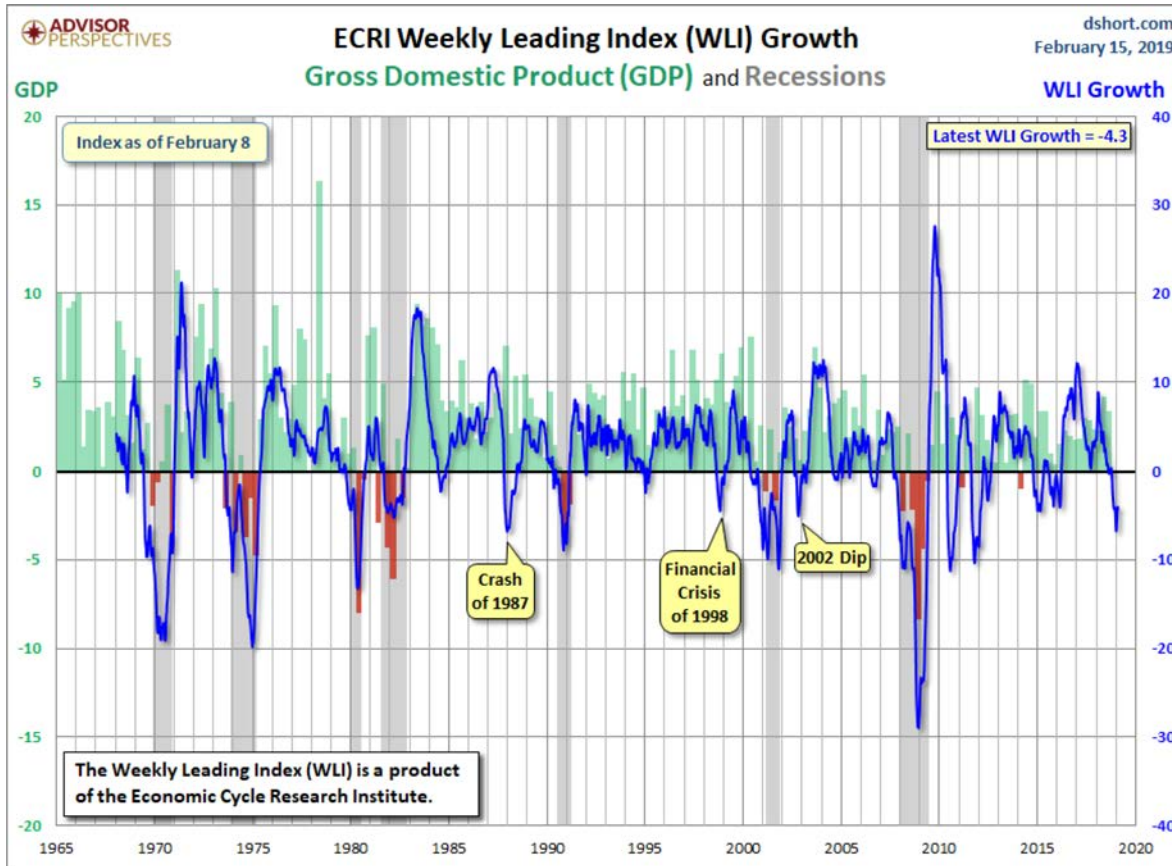


Chart 5: The ECRI WLI dropped last week and is down -4.3% year over year. Growth is still slowing in the US.



Chart 6: The Vanguard Total World Stock ETF rallied 2.36% last week and closed above key resistance. Global stocks continue to rally in the face of slowing economic data.

Symbol	Name	Close	Chg	% Chg
\$RUT	\$RUT - Russell 2000 Small Cap Index	1569.25	62.85	4.17
\$CAC	\$CAC - French CAC 40 Index	5153.19	191.55	3.86
\$STRAN	\$STRAN - Dow Jones Transportation Average	10567.69	390.66	3.84
\$DAX	\$DAX - German DAX Composite	11299.80	393.02	3.60
\$INDU	\$INDU - Dow Jones Industrial Average	25883.25	776.92	3.09
\$SPDAUDP	\$SPDAUDP - Dividend Aristocrats	1180.74	34.63	3.02
\$NIKK	\$NIKK - Tokyo Nikkei Average	20900.63	567.46	2.79
\$WLSH	\$WLSH - Wilshire 5000 Composite	28804.29	747.71	2.67
QUAL	QUAL - iShares Edge MSCI USA Quality Factor ETF	86.03	2.24	2.67
\$RUA	\$RUA-Russell 3000 Index	1643.45	42.31	2.64
\$SPX	\$SPX - S&P 500	2775.60	67.72	2.50
\$SSEC	\$SSEC - Shanghai Stock Exchange	2682.39	64.16	2.45
\$NDX	\$NDX - Nasdaq 100 Index	7055.18	142.05	2.05
MTUM	MTUM - iShares MSCI USA Momentum Factor ETF	109.46	2.18	2.03
\$MSEAFE	\$MSEAFE - MSCI EAFE	1840.10	35.37	1.96
\$MSWORLD	\$MSWORLD - MSCI World ex USA	1840.52	34.38	1.90
SPLV	SPLV - Invesco S&P 500 Low Volatility ETF	51.04	0.65	1.29
\$HSI	\$HSI - Hang Seng	27900.84	-45.48	-0.16
\$MSEMF	\$MSEMF - Emerging Markets	1030.64	-5.39	-0.52
\$VIX	\$VIX - Volatility Index - New Methodology	14.91	-0.81	-5.15

# EQUITY MARKET RECAP

- The Russell 2000 was the leader last week, gaining 4.17%.
- The Wilshire 5000 rose 2.67%.
- Emerging markets lagged, dropping -0.52% on the week.
- Energy was the strongest sector, gaining 5.05%.
- Dividend growth was the strongest factor, gaining 3.02%.
- Low Volatility was the weakest factor, only gaining 1.29%.

XLE Energy Select Sector SPDR Fund NYSE  
15-Feb-2019

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Open 62.64 High 66.17 Low 62.46 Close 66.12 Volume 56.6M Chg +3.18 (+5.05%) ▲

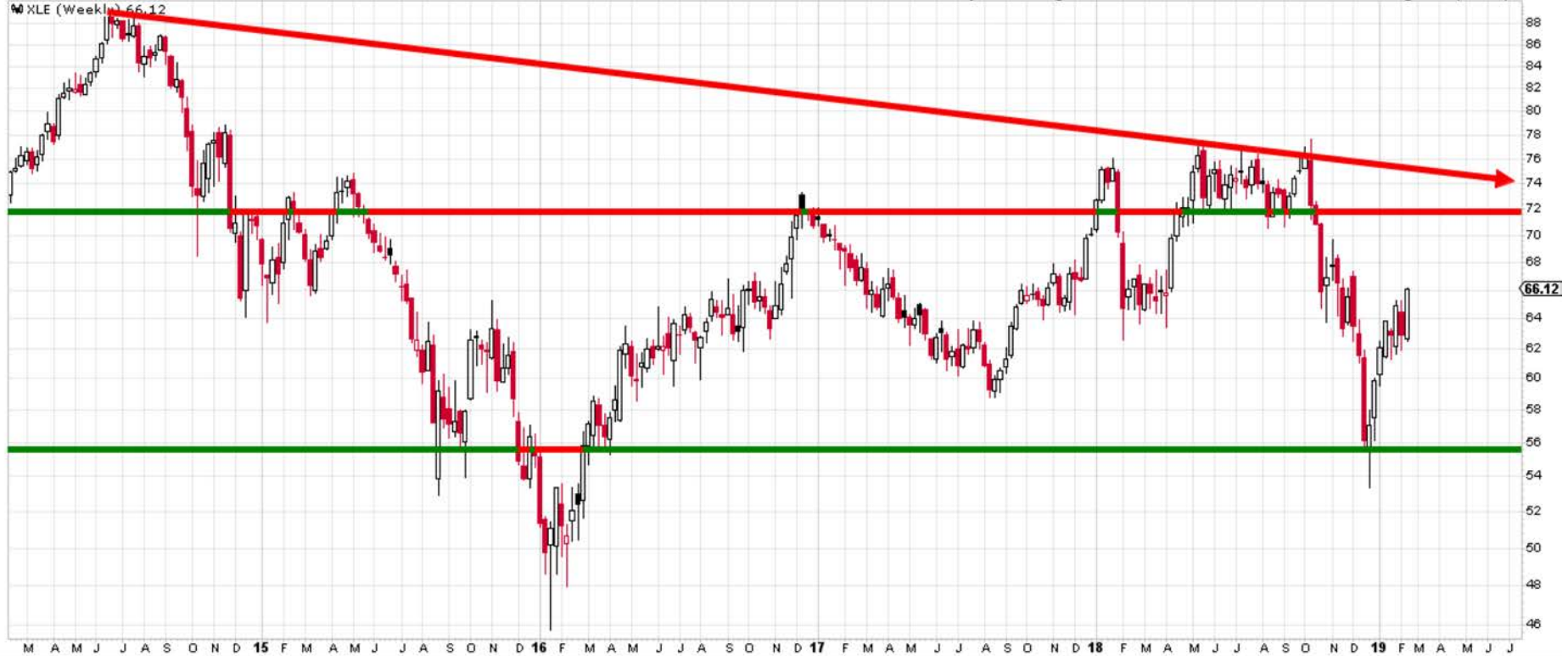


Chart 7: Energy gained 5.05% last week as the strongest sector. It is still well below resistance and in a long-term negative trend.



Chart 8: The Russell 2000 rallied 4.17% last week in an encouraging move for risk assets. Small caps leading could signal a potential uptick in future economic growth. We want to see more of that type of activity going forward.



Chart 9: Emerging Markets fell -0.52% last week despite the rally in global equities. The trend is still down in broader Emerging Markets despite leading on the way up.

# FIXED INCOME RECAP

Symbol	Name	Close	Chg	% Chg
\$YC3MO	\$YC3MO - 3mo - 10yr yield curve	0.23	0.03	15.00
\$UST2Y	\$UST2Y - 2 year yield	2.52	0.07	2.86
\$UST5Y	\$UST5Y - 5 year yield	2.49	0.05	2.05
\$UST10Y	\$UST10Y - 10 year yield	2.66	0.03	1.14
\$UST30Y	\$UST30Y - 30 year yield	3.00	0.03	1.01
\$UST20Y	\$UST20Y - 20 year yield	2.84	0.02	0.71
\$UST3M	\$UST3M - 3 month yield	2.43	0.00	0.00
\$YC2YR	\$YC2YR - 2-10 yield curve	0.14	-0.04	-22.22

- The 2-10 year yield curve finished the week at 0.14%, down 4 basis points from the previous week.
- The 3 mo-10 year Treasury yield curve closed the week at 0.23%, up 3 basis points from the previous week.
- The benchmark 10 year Treasury bond yield rallied 3 basis points to close at 2.66%
- Long-term Treasury bonds finished the week down -0.30% (TLT).

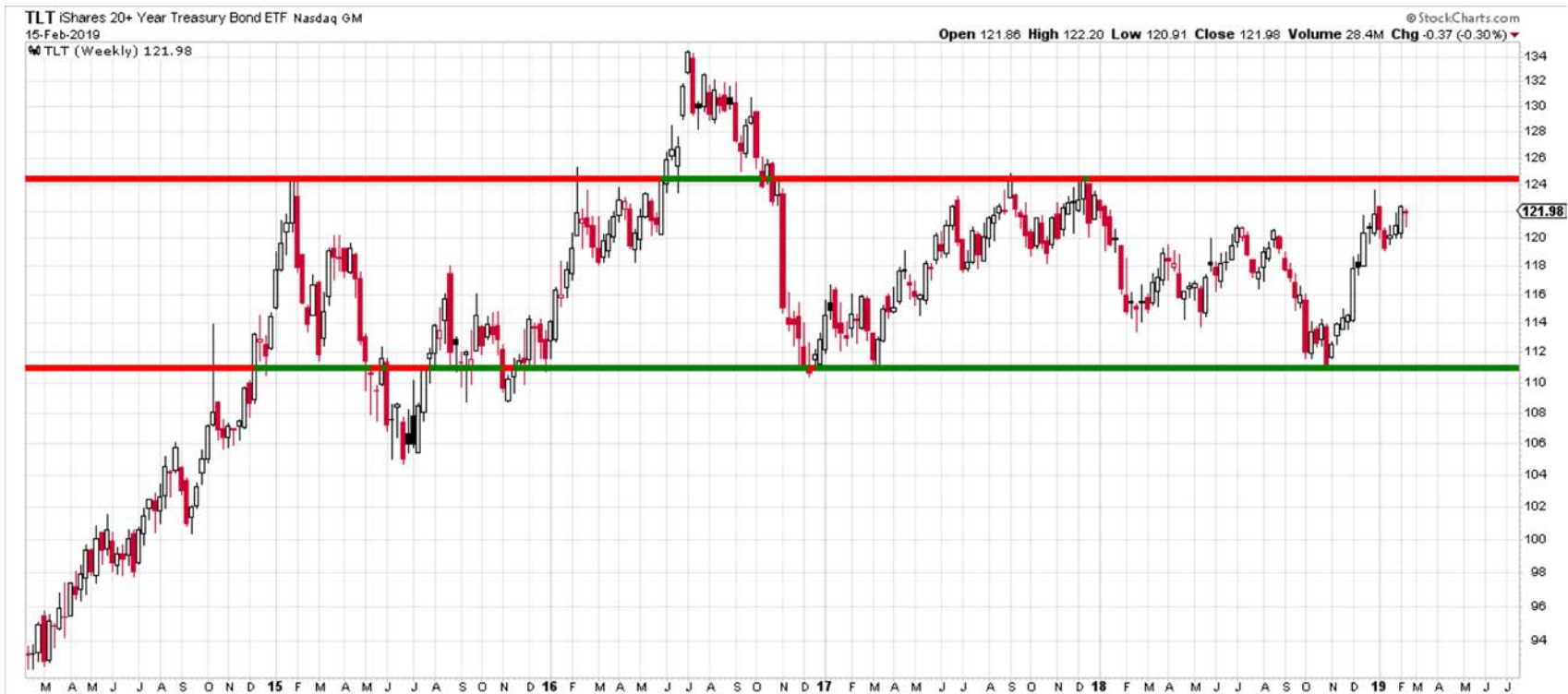


Chart 10: The iShares 20 Year Treasury Bond ETF (TLT) fell -0.30% last week. It remains in a wide trading range. A breakout in either direction will potentially offer clues on future economic growth.



# CURRENCY MARKET RECAP

Symbol	Name	Close	Chg	% Chg
\$NYXBT	\$NYXBT - Daily Solid Line, 1280	3563.83	154.23	4.52
\$AUDJPY	\$AUDJPY - Australian Dollar to Japanese Yen (NBD)	78.81	1.04	1.33
\$USDJPY	\$USDJPY - US Dollar to Japanese Yen (EOD)	110.40	0.65	0.59
\$USD	\$USD - US Dollar Index - Cash Settle (EOD)	96.74	0.32	0.34
\$EURJPY	\$EURJPY - Euro to Japanese Yen (NBD)	124.66	0.39	0.31
\$CADUSD	\$CADUSD - Canadian Dollar to US Dollar (NBD)	0.75	0.00	0.16
\$EURUSD	\$EURUSD - Euro to US Dollar (NBD)	1.13	-0.00	-0.27
\$EURUSD	Euro to US Dollar (NBD) (\$EURUSD)	1.13	-0.00	-0.27
\$GBPUSD	\$GBPUSD - British Pound to US Dollar (NBD)	1.29	-0.00	-0.35
\$JPYEUR	\$JPYEUR - Weekly Solid Line, 1280	0.80	-0.00	-0.37
\$JPYUSD	\$JPYUSD - Weekly Solid Line, 1280	0.91	-0.01	-0.58

- The Australian dollar rallied over 1.33% against the Yen last week.
- The US dollar rose 0.34% on a trade weighted basis, finishing at 96.74
- The Yen fell -0.58% against the US dollar.
- Bitcoin rose 4.52% on the week. It is currently 3563.83.



Chart 11: The US dollar rallied 0.34% over the course of the week. It remains in an upward trend and is approaching an important test at 97.

# COMMODITIES

Symbol	Name	Close	Chg	% Chg
\$BRENT	\$BRENT - Weekly Solid Line, 1280	66.25	4.15	6.68
\$WTIC	\$WTIC - Crude oil	55.98	3.26	6.18
\$PALL	\$PALL - Weekly Solid Line, 1280	1407.20	36.00	2.63
\$SUGAR	\$SUGAR - Weekly Solid Line, 1280	0.13	0.00	2.28
\$CRB	\$CRB - Reuters/Jefferies CRB Index	181.33	3.29	1.85
\$PLAT	\$PLAT - Weekly Solid Line, 1280	806.90	4.40	0.55
\$GOLD	\$GOLD - Gold - Continuous Contract (EOD)	1322.10	3.60	0.27
\$CORN	\$CORN - Weekly Solid Line, 1280	374.75	0.50	0.13
\$SILVER	\$SILVER - Weekly Solid Line, 1280	15.74	-0.07	-0.42
\$COPPER	\$COPPER - Copper - Continuous Contract (EOD)	2.80	-0.01	-0.43
\$SOYB	\$SOYB - Weekly Solid Line, 1280	907.50	-7.00	-0.77
\$COTTON	\$COTTON - Weekly Solid Line, 1280	71.86	-0.69	-0.95
\$WHEAT	\$WHEAT - Weekly Solid Line, 1280	504.25	-13.00	-2.51
\$LUMBER	\$LUMBER - Weekly Solid Line, 1280	408.30	-10.80	-2.58

- Brent crude finished the week up 6.68%.
- Palladium closed up 2.63%, continuing its strong rally.
- Copper closed down -0.43% for the week.
- The CRB index was up 1.85%.
- Gold finished up 0.27%, closing at 1322.10.



Chart 12: Brent crude rallied big for the week, breaking out of a short-term consolidation. It is approaching resistance at the 70 level.

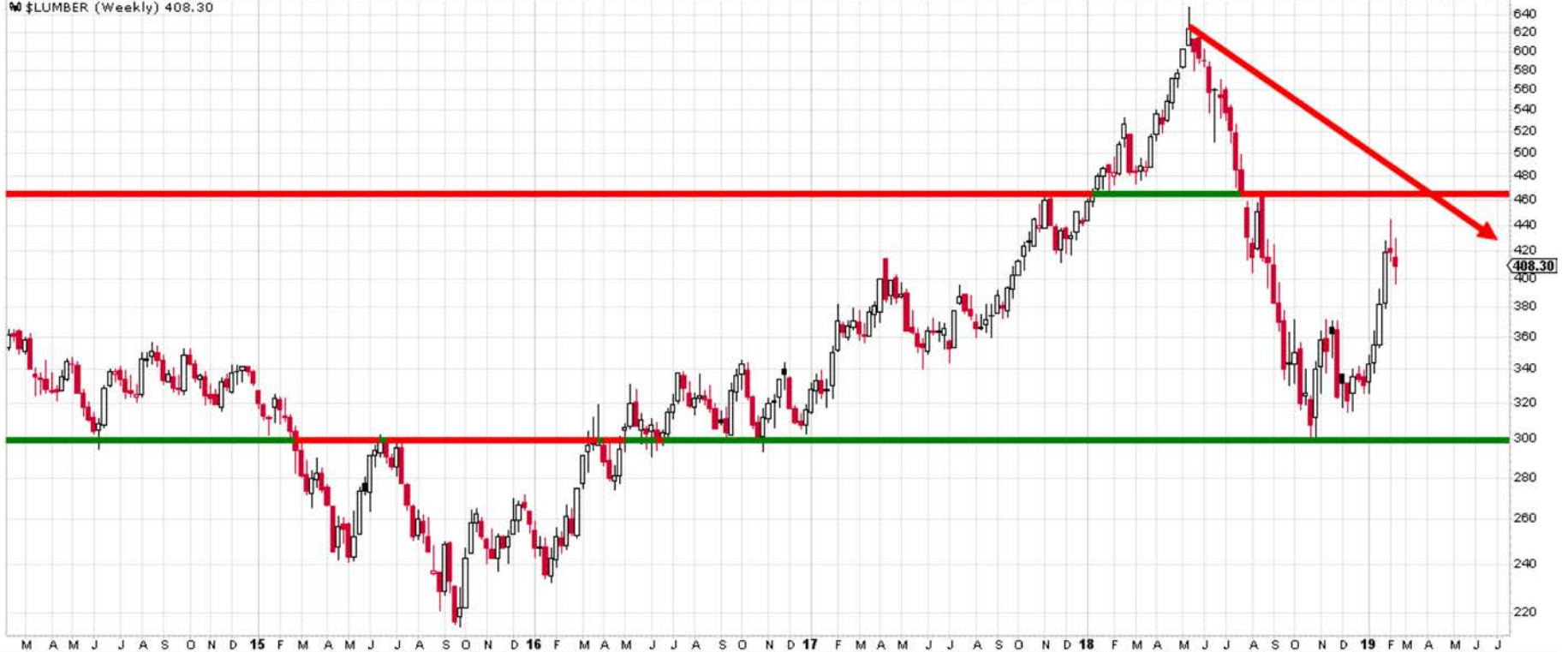


Chart 13: Lumber fell -2.58% last week. It has been one of the leaders in the commodity space and bottomed prior to the market. It remains in a negative trend.

# MARKET RELATIONSHIPS

Symbol	Name	Close	Chg	% Chg
\$WLSH:AGG	\$WLSH:AGG - Weekly Solid Line, 1280	268.45	7.07	2.70
\$WLSH:\$GOLD	\$WLSH:\$GOLD - New Favorite	21.79	0.51	2.39
SPHB:SPLV	SPHB:SPLV - Weekly Solid Line, 1280	0.81	0.02	2.25
\$SML:\$SPX	\$SML:\$SPX - Weekly Solid Line, 1280	0.35	0.01	1.80
JNK:TLT	JNK:TLT - New Favorite	0.29	0.00	1.07
VIG:SPY	VIG:SPY - New Favorite	0.39	0.00	0.76
\$WLSH:\$MSWORLD	\$WLSH:\$MSWORLD - New Favorite	15.65	0.12	0.75
\$SPDAUDP:\$SPX	\$SPDAUDP:\$SPX - Weekly Solid Line, 1280	0.43	0.00	0.51
TIP:TLT	TIP:TLT - New Favorite	0.91	0.00	0.38
MTUM:SPY	MTUM:SPY - New Favorite	0.39	-0.00	-0.51
\$COPPER:\$GOLD	\$COPPER:\$GOLD - New Favorite	0.00	0.00	-0.70
SPLV:SPY	SPLV:SPY - New Favorite	0.18	-0.00	-1.23
\$MSEMF:\$MSEAFE	\$MSEMF:\$MSEAFE - New Favorite	0.56	-0.01	-2.43
\$LUMBER:\$GOLD	\$LUMBER:\$GOLD - New Favorite	0.31	-0.01	-2.84

- Stocks rallied against bonds last week.
- Small caps rallied against large caps, gaining 1.80%.
- Stocks rallied 2.39% against gold last week.
- US stocks gained against international equities.
- High Beta beat out low volatility equities.
- Dividend growth rallied against the S&P 500.
- Copper fell -0.70% against gold.



Chart 14: The Wilshire 5000 gained 2.70% against bonds last week. The relationship still favors bonds and a defensive posturing.



Chart 15: Momentum remains weak against the S&P 500. It lost another -0.51% against the broad market last week. We would like to see this factor regain leadership.





Chart 16: Dividend growth gained 0.75% against the S&P 500 last week. This factor remains favored in a growth slowing environment.



Chart 17: Copper fell -0.70% against gold last week. It remains in range. A break in either direction will offer up clues as to future economic and market direction.

# SUMMARY & PLAYBOOK

- Economic growth continues to slow globally and domestically.
- The ECRI Weekly Leading Index is down -4.3% year over year.
- The Wilshire 5000 and MSCI World Ex US indexes remain in negative trends relative to bonds.
- Global equities had a nice rally last week with the Vanguard Total World Market gaining 2.36%.
- The Dividend Growth Factor was the top performing factor for the week.
- Brent Crude rallied 6.68% for the week and Energy was the top performing sector.
- The US dollar continued to display strength, gaining 0.34% on a trade weighted basis.

## Overweights:

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

## Underweights:

Credit, Momentum, Cyclical,  
Growth.

# DISCLOSURE

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