WEALTHSHIELD

Market Outlook | February 4th, 2019

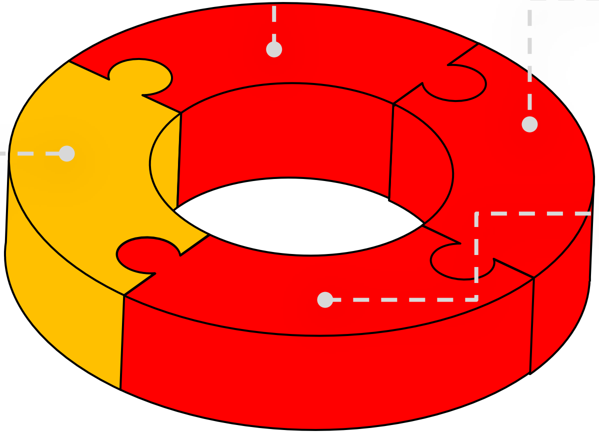
INVESTMENT FRAMEWORK

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?

TIME TO HIT THE SLOPES

Our process centers on data to determine the direction of economic growth and where we are in the current business cycle. We are not attempting to pass judgement on whether the economy is "good" or "bad". In essence, we look at the data and determine whether conditions are slowing or growing. The acceleration or deceleration of market trends and economic growth tell us how to position portfolios given those conditions.

Acceleration means that we have a positive rate of change in market prices and economic growth. In this type of environment, we want to take risk. Factors like momentum and growth tend to outperform. Global equities in general are favored as an asset class during a growth period. On the contrary, when the slope of market prices and economic growth is negative, you don't want to be in factors like momentum and growth. In fact, decelerating environments can be terrible regimes for risk taking in general. The factors that would thrive in this type of environment would be low volatility and high quality. Bonds, gold and other defensive assets (cash, global macro,etc.) could also do well.

However, things don't move in a straight line--there is nothing linear about markets. There will always be volatility and noise that we must learn to filter through in order to make prudent investment decisions. During periods of accelerating prices and economic growth, there are often corrections. These corrections are seen when growth pulls-back on a short-term time horizon. These corrections happen in both accelerations and decelerations. Nevertheless, the prudent investor learns to ignore this noise over time and pay attention to the actual rate of change or slope.

This is a main reason why we built our framework to be rules-based, quantitative, and followed with extreme discipline. We don't care how often the data changes, but when/if it does our positions shall change as well. No questions asked. The framework does not help us predict or form opinions, but instead it enables us to react to data in a prudent, probabilistic manner.

TIME TO HIT THE SLOPES

Since the framework moved negative in late October, we have been recommending a defensive posture. In these reports we discussed the negative rate of change in economic growth, inflation, and market prices; both domestic and international. The shift in our framework signaled a potential rotation in a higher volatility regime.

"We believe that long-term rates will move down because we believe we have seen the peak in growth and inflation."
- October 19, 2018

Defensive exposures have trounced offensive ones since our framework moved negative. Since November 1, 2018 the S&P 500 is down -0.68%, and the momentum factor is down -1.68%. At the same time, long-term Treasury bonds are up 7.40% and the low volatility factor is up 3.93%. Gold is up 6.75% over that time period. This data includes January market activity.

Other than the Fed moving from a restrictive to more neutral stance, nothing has changed within our framework. We have seen improvements in market prices and economic activity, but overall the rate of change data still indicates an environment where we should be defensive. The Economic Cycle Research Institute's Weekly Leading Index is still negative year over year, even though it has improved over the last couple of weeks. In fact, economic data in the US has surprised to the upside recently on several reports. The Jobs report, ISM report, and New Home Sales from last week were big beats versus expectations. Nevertheless, growth is still slowing.

Market prices in both global and domestic equities surged last month. Still, both the Wilshire 5000 and MSCI All World Ex-US remain below their 10 month simple moving averages. We welcome a reversal back into a positive market trend and accelerating economic growth; however, until that becomes reality, our framework will remain defensively positioned. The Fed simply responded to the growth slowing data like we thought they would. Nevertheless, they are not easing at the moment--only moving Dovish by ceasing to tighten. Will this be enough? We don't know, but we will keep and open mind and respond to the slopes.

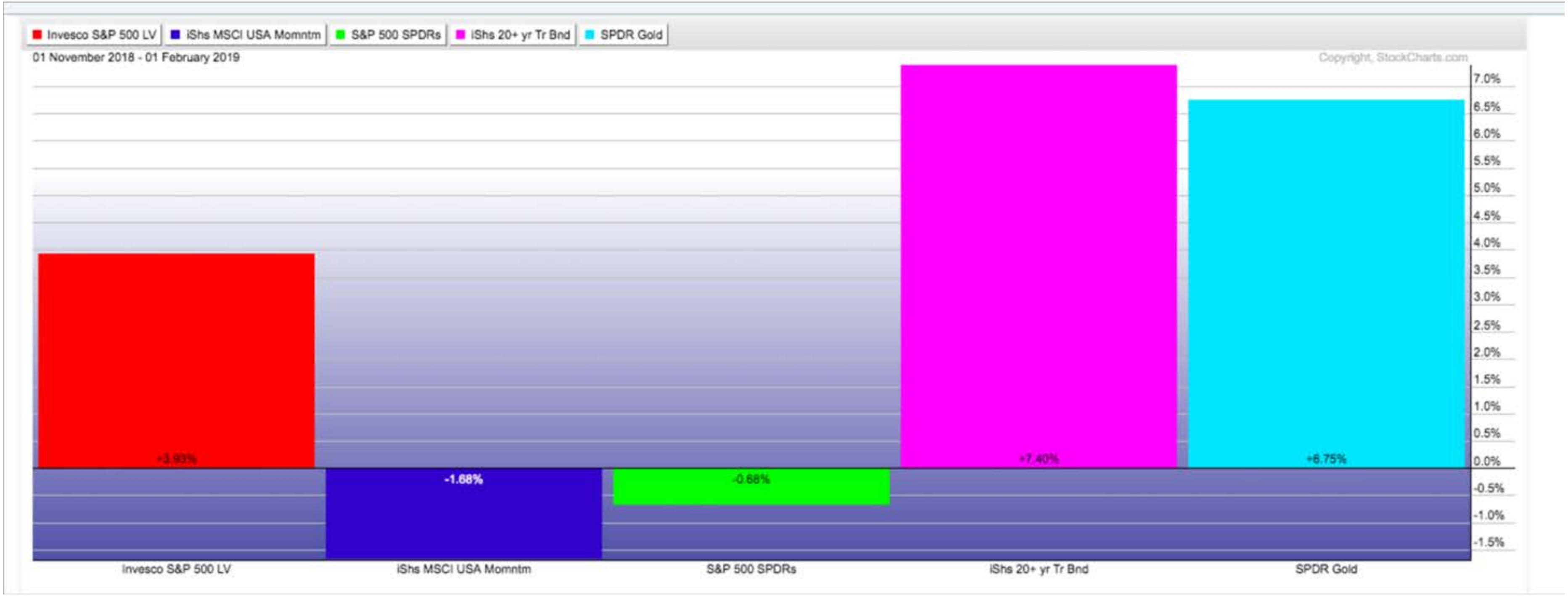


Chart 1: Defensive versus offensive exposures. The defensive playbook has been superior to offensive assets since our framework turned negative at the end of October 2018.

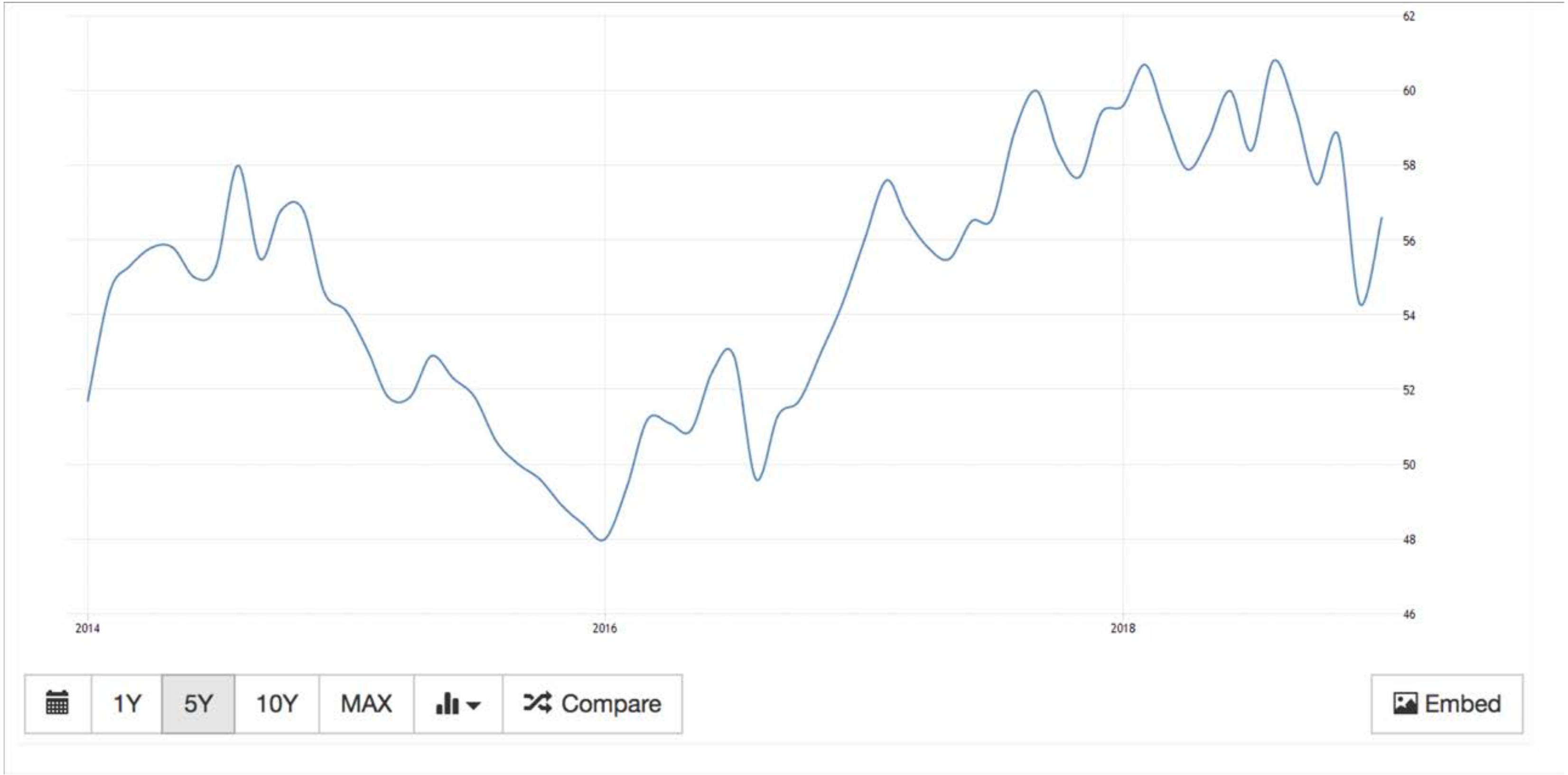


Chart 2: ISM Manufacturing PMI surprised to the upside in January. This is one of the many important data points that have improved. The trend is still slowing for manufacturing, but recent data is encouraging; Source: www.tradingeconomics.com

Chart 3: New Home Sales surged 16.9% month over month. This was a big jump and encouraging data point from the housing market. Housing was weak throughout 2018, so any improvement is welcome.
Source: www.tradingeconomics.com

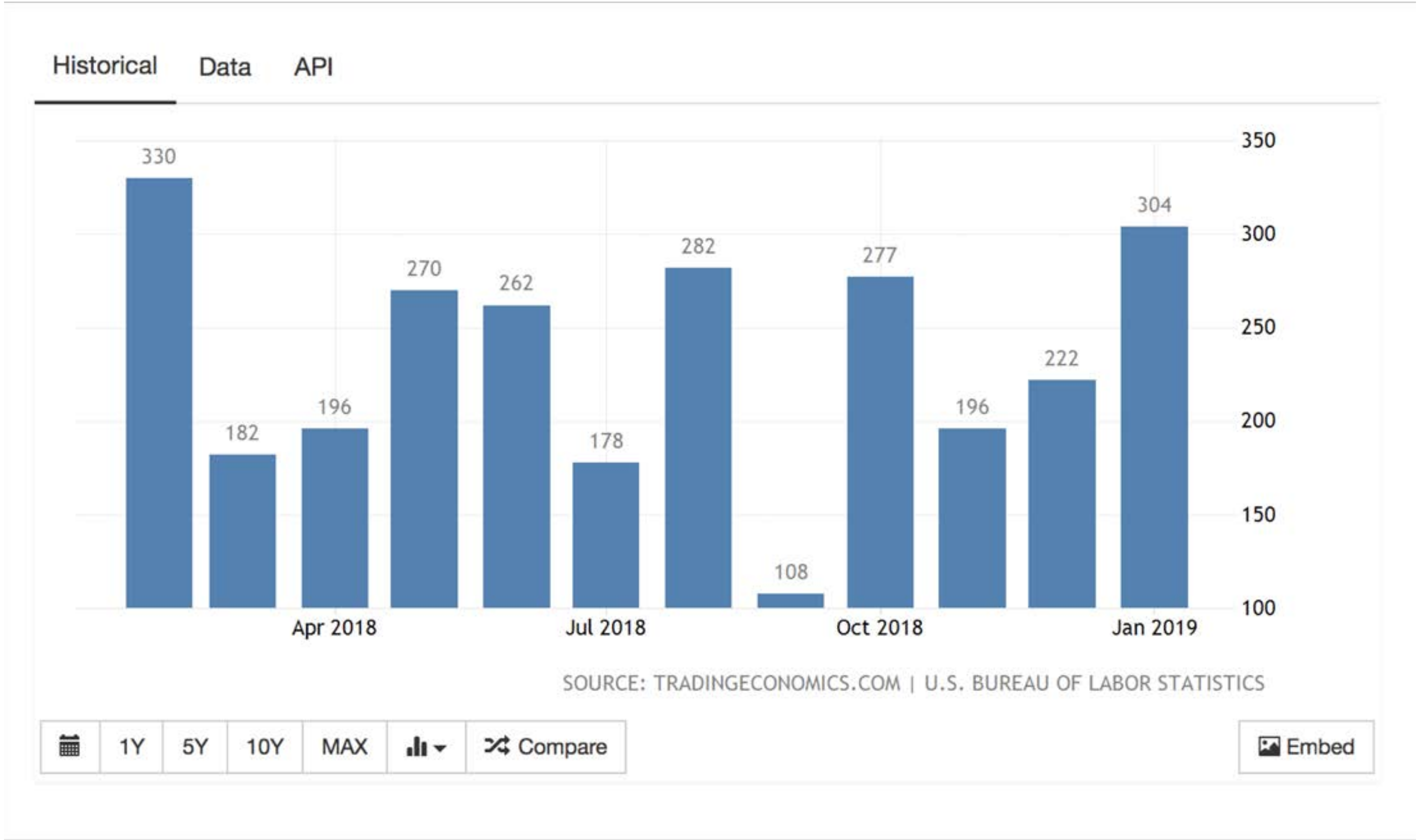


Chart 4: Non-farm Payrolls jumped 304,000 for the month of January. This was a major surprise and one of the largest beats relative to expectations (167,000) in history. December was revised down to 222,000 jobs but employment remains rather robust. Source: tradingeconomics.com

Chart 5: The unemployment rate did increase for the second consecutive month and closed above its 12 month moving average again. This is signaling that the employment picture may be making a turn for the worst. We will have to see.

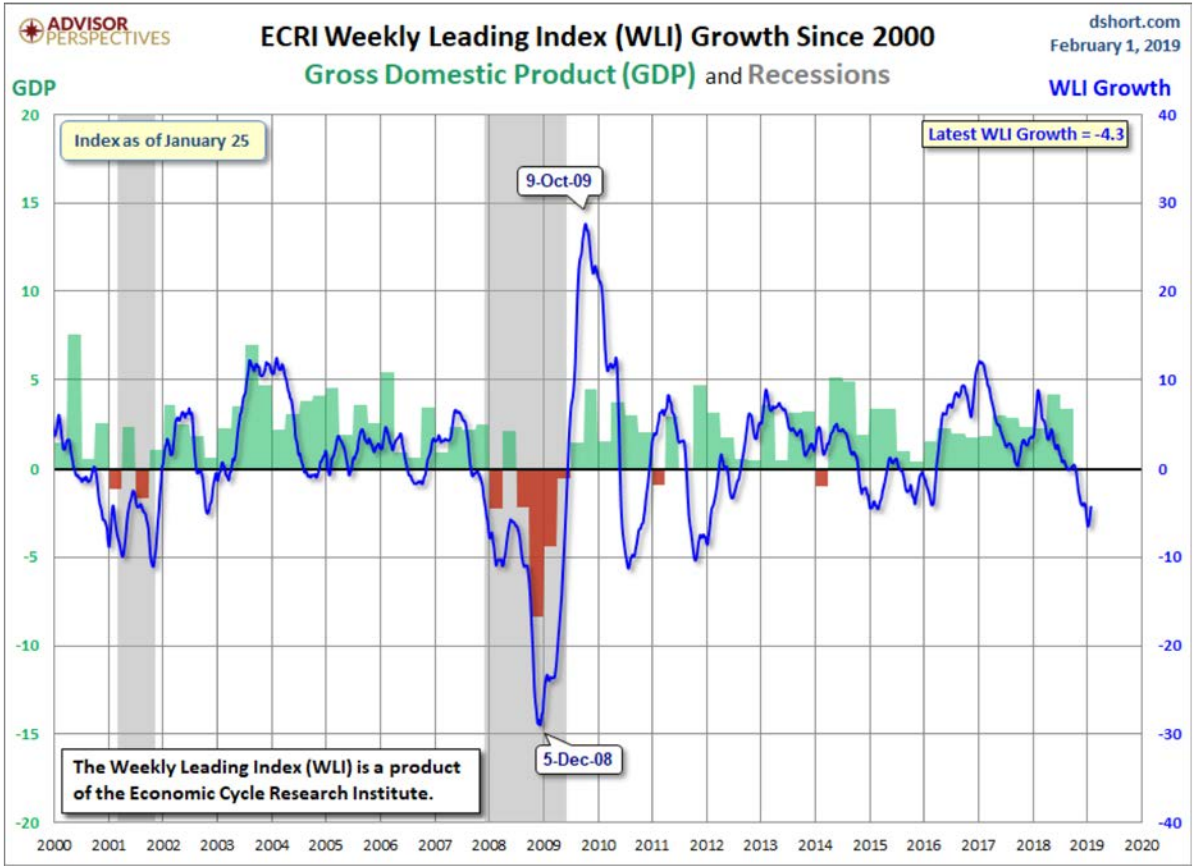


Chart 6: ECRI Weekly Leading Index. Growth is still slowing despite short-term improvements.

EQUITY MARKET RECAP

Symbol	Name	Close	% Chg
$SPDAUDP	$SPDAUDP - Dividend Aristocrats	1137.81	2.09
$TRAN	$TRAN - Dow Jones Transportation Average	10123.99	2.04
$CAC	$CAC - French CAC 40 Index	5019.26	1.90
$MSEMF	$MSEMF - Emerging Markets	1050.20	1.73
$RUA	$RUA-Russell 3000 Index	1599.07	1.64
$WLSH	$WLSH - Wilshire 5000 Composite	28026.70	1.62
$SPX	$SPX - S&P 500	2706.53	1.57
$INDU	$INDU - Dow Jones Industrial Average	25063.89	1.32
$HSI	$HSI - Hang Seng	27930.74	1.31
$NDX	$NDX - Nasdaq 100 Index	6875.52	1.30
$RUT	$RUT - Russell 2000 Small Cap Index	1502.05	1.29
$MSWORLD	$MSWORLD - MSCI World ex USA	1829.98	0.99
$MSEAFE	$MSEAFE - MSCI EAFE	1830.04	0.90
$SSEC	$SSEC - Shanghai Stock Exchange	2618.23	0.63
$NIKK	$NIKK - Tokyo Nikkei Average	20788.39	0.07
$DAX	$DAX - German DAX Composite	11180.66	-0.90
$VIX	$VIX - Volatility Index - New Methodology	16.14	-7.35

Source: www.stockcharts.com

- Emerging Markets were the leaders last week, gaining 1.73%.
- The Wilshire 5000 rose 1.62%.
- International developed markets were the laggards, rising 0.90%.
- Energy was the top performing sector, up 3.11%.
- The Low Volatility factor (SPLV) gained 2.79% for the week and was the strongest factor.
- Dividend growth (Dividend Aristocrats) increased 2.09%.

Chart 7: The Low Volatility Factor ETF (SPLV) is close to breaking to new highs and is above its 40 week moving average. It was the strongest factor last week.

Chart 8: Wilshire 5000 increased 1.62% last week but is still below its 40 week moving average.

Chart 9: MSCI All World Ex-US rose 0.99% last week. It is still in a negative long-term trend despite the recent strength.

FIXED INCOME RECAP

Symbol	Name	Close	Chg
$YC2YR	$YC2YR - 2-10 yield curve	0.18	0.02
$UST3M	$UST3M - 3 month yield	2.40	0.01
$UST30Y	$UST30Y - 30 year yield	3.03	-0.03
$UST20Y	$UST20Y - 20 year yield	2.88	-0.04
$UST10Y	$UST10Y - 10 year yield	2.70	-0.06
$UST2Y	$UST2Y - 2 year yield	2.52	-0.08
$UST5Y	$UST5Y - 5 year yield	2.51	-0.08
$YC3MO	$YC3MO - 3mo - 10yr yield curve	0.30	-0.07

Source: www.stockcharts.com

- The 2-10 year yield curve finished the week at 0.18%, up from the previous week.
- The 3 mo-10 year Treasury yield curve closed the week at 0.30%, down 7 basis points from the previous week.
- The benchmark 10 year Treasury bond yield dropped 6 basis points for the week and finished at 2.70%.
- Long-term Treasury bonds finished the week up 0.58% (TLT).

Chart 10: Long-Term Treasury Bonds (TLT) rallied 0.58% last week. They are in a positive long-term trend and above the 40 week moving average.

CURRENCY MARKET RECAP

Symbol	Name	Close	% Chg
$CADUSD	$CADUSD - Canadian Dollar to US Dollar (NBD)	0.76	1.02
$AUDJPY	$AUDJPY - Australian Dollar to Japanese Yen (NBD)	79.37	0.99
$EURJPY	$EURJPY - Euro to Japanese Yen (NBD)	125.45	0.42
$EURUSD	$EURUSD - Euro to US Dollar (NBD)	1.15	0.41
$USDJPY	$USDJPY - US Dollar to Japanese Yen (EOD)	109.48	0.01
$JPYUSD	$JPYUSD - Weekly Solid Line, 1280	0.91	0.00
$USD	$USD - US Dollar Index - Cash Settle (EOD)	95.30	-0.17
$JPYEUR	$JPYEUR - Weekly Solid Line, 1280	0.80	-0.38
$GBPUSD	$GBPUSD - British Pound to US Dollar (NBD)	1.31	-0.91
$NYXBT	$NYXBT - Daily Solid Line, 1280	3435.15	-3.29

Source: www.stockcharts.com

- The Canadian Dollar gained 1.02% against the US dollar last week.
- Australian Dollar rose 0.99% against the Japanese Yen.
- The dollar fell -0.17% on a trade weighted basis based on a Dovish Fed.
- The Euro was stronger against the dollar and Yen by 0.41% and 0.42% respectively.
- Bitcoin fell -3.29% last week against the dollar, closing at 3435.15.

Chart 11: The Australian dollar has shown some strength against the Japanese yen to start 2019. However, this currency pair remains in a negative long-term trend.

COMMODITIES

Symbol	Name	Close	% Chg
$LUMBER	$LUMBER - Weekly Solid Line, 1280	419.20	9.88
$WTIC	$WTIC - Crude oil	55.26	2.92
$GOLD	$GOLD - Gold - Continuous Contract (EOD)	1322.10	1.85
$BRENT	$BRENT - Weekly Solid Line, 1280	62.75	1.80
$COPPER	$COPPER - Copper - Continuous Contract (EOD)	2.77	1.61
$SILVER	$SILVER - Weekly Solid Line, 1280	15.93	1.48
$SUGAR	$SUGAR - Weekly Solid Line, 1280	0.13	1.29
$PLAT	$PLAT - Weekly Solid Line, 1280	826.70	1.03
$WHEAT	$WHEAT - Weekly Solid Line, 1280	524.25	0.82
$CRB	$CRB - Reuters/Jefferies CRB Index	180.55	-0.07
$PALL	$PALL - Weekly Solid Line, 1280	1313.60	-0.47
$CORN	$CORN - Weekly Solid Line, 1280	378.25	-0.53
$COTTON	$COTTON - Weekly Solid Line, 1280	73.64	-0.66
$SOYB	$SOYB - Weekly Solid Line, 1280	917.75	-0.81

Source: www.stockcharts.com

- Lumber continued its monster rally, rising 9.88% for the week.
- Crude oil rallied 2..92% for the week, closing at 55.26.
- Soybeans were weak, finishing down -0.81% for the week.
- Gold was up 1.85%.
- The Reuters/Jefferies CRB Index was down -0.07%.

Chart 12: Lumber neared resistance at the 40 week moving average and rallied almost 10% for the week.

Chart 13: Crude oil rose 2.92% last week, but remains in a bearish trend.

MARKET RELATIONSHIPS

Symbol	Name	Close	% Chg
$LUMBER:$GOLD	$LUMBER:$GOLD - New Favorite	0.32	7.89
$WLSH:$AKG	$WLSH:$AKG - New Favorite	262.28	1.33
SPLV:SPY	SPLV:SPY - New Favorite	0.18	0.87
$MSEMF:$MSEAFE	$MSEMF:$MSEAFE - New Favorite	0.57	0.82
$WLSH:$MSWORLD	$WLSH:$MSWORLD - New Favorite	15.32	0.62
$SPDAUDP:$SPX	$SPDAUDP:$SPX - Weekly Solid Line, 1280	0.42	0.51
TIP:TLT	TIP:TLT - New Favorite	0.92	0.33
HYG:IEF	HYG:IEF - New Favorite	0.81	0.31
MTUM:SPY	MTUM:SPY - New Favorite	0.40	0.16
$EJK:$EJN	$EJK:$EJN - Weekly Solid Line, 1280	1.68	-0.09
$COPPER:$GOLD	$COPPER:$GOLD - New Favorite	0.00	-0.23
$WLSH:$GOLD	$WLSH:$GOLD - New Favorite	21.20	-0.23
$SML:$SPX	$SML:$SPX - Weekly Solid Line, 1280	0.34	-0.41
VIG:SPY	VIG:SPY - New Favorite	0.38	-0.65
SPHB:SPLV	SPHB:SPLV - Weekly Solid Line, 1280	0.81	-1.37

Source: www.stockcharts.com

- Lumber rallied substantially against gold. Going up another 7.89% this week.
- Low Volatility rallied 0.87% against the S&P 500, signaling a defensive rotation.

- Copper fell by -0.23% against gold last week.
- Stocks gained 1.33% against bonds.
- Stocks lost -0.65% against gold.
- Small caps dropped -0.41% against large caps

Chart 14: The Wilshire 5000 rose 1.33% against bonds last week. It remains below its 40 week moving average.

Chart 15: Momentum was only slightly stronger relative to the S&P 500 last week. This relationship showed negative divergence versus the S&P 500 as it failed to hit new highs.

Chart 16: The Low Volatility factor gained almost 1% against the S&P 500 last week. This is another divergence relative to the broader market as we would expect this relationship to hit new lows as the S&P 500 hits new highs.

Chart 17: Copper dropped -0.23% against Gold. This relationship continues to support lower yields and slowing inflation.

Chart 18: Dow Jones Industrial Average Index

Dow Theory Update

- The Dow rallied enough to close above its 10 month simple moving average in January. The Dow is now in a positive trend.
- The Dow Transports failed to confirm the industrials index as it closed below its 10 month simple moving average.
- This is a classic negative non-confirmation from a Dow Theory perspective.
- According to our interpretation of Dow Theory, we believe we are still in a negative primary trend.
- We want to see the Transports index break above its 10 month moving average to confirm a new uptrend.

Chart 19: Market entered a higher volatility regime last year as the VIX took out the top of the resistance band around 18. It quickly re-entered a lower volatility regime, but made a higher low and propelled back into the higher volatility zone. The VIX is at a critical test zone now, at 16. A monthly close below 16 could signify that we are back in a low volatility environment.

SUMMARY & PLAYBOOK

- Economic growth improved as the ISM, Payrolls, and New Home Sales data came in way better than expected.
- However, growth is still slowing on a rate of change basis. The ECRI Weekly Leading Index is down -4.3% year over year.
- The Wilshire 5000 and MSCI World Ex US indexes remain below their 10 month simple moving averages, suggesting that they are broadly in negative trends.
- Stocks gained on the week, continuing the risk on rally that began in late December 2018.
- Emerging markets were the strongest performer last week and have broken above their 40 week moving average. Emerging markets remain overweight relative to International developed in our asset allocation models.
- The Low Volatility factor was the top performing factor last week.
- Treasury bonds and Gold gained on a dovish Fed.

Overweights:

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

Underweights:

Credit, Momentum, Cyclicals, Growth

DISCLOSURE

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