WealthShield

Market Outlook | May 13, 2019

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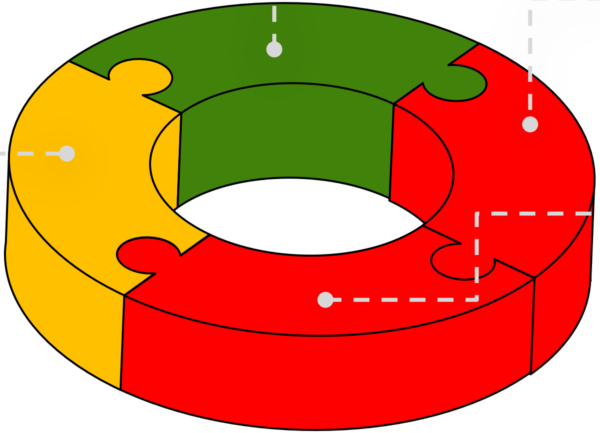
INVESTMENT FRAMEWORK

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?

TIMING MATTERS

It has always been interesting that financial media and market commentators like to compare various strategies and disciplines to buy-and-hold investing. Since when has buying something blindly and holding it forever been a good investment strategy? Based on the data we look at, it appears that the success of buy-and-hold investing is largely based on the starting point. In other words, timing matters.

For instance, take the hypothetical case of someone buying and holding the S&P 500 at the start of 1929 and holding it for the next 20 years. That investor would have earned a little over 2% per year on average for 20 years. That is right. So much for the 10%-12% expected market returns we think we will receive. A dollar invested (including dividends and inflation) would have grown to $1.54. Now, you are probably thinking that was a long time ago, prior to the great depression. You are right. Let's examine a more recent time period.

If an investor would have invested at the beginning of 2000 and held it until the end of 2018, they too would have earned a little more than 2% annually (after inflation and dividends). A dollar invested on January 1, 2000 would have been $1.64 at the end of 2018. These time periods are not unique. From January 1901 through 1921, the market would have compounded at 1.60% per year. From 1962 through 1982, an investment in the S&P 500 would have grown at 1.49% per year. Imagine investing for 20 years and earning 2% after inflation.

These time periods all have one thing in common: high valuations. In fact, according to the cyclically adjusted price to earnings ratio (CAPE), today is more expensive than most of the aforementioned time periods, with the exception of the 2000 time period. Valuations are not a timing tool and they tell us nothing about the path we will take to eventually reach low average returns. However, they do tell us, with historical accuracy, that returns will be well below average going forward. We have no reason to not expect similar, post-inflation returns as we witnessed historically when valuations were this elevated. Thus, it is easy to conclude that buy-and-hold investing will most likely disappoint going forward. The solution is simple, you have to get creative with portfolios. Go where the value is (emerging markets, international developed, etc.), have a disciplined risk management process, and look to alternative investments. As everyone runs to market capitalization weighted index funds, we think investors should be running to alternatives.

WEEKLY SUMMARY

Economic Activity

- The ECRI WLI gained 0.5 from the week prior. The four week moving average of the WLI is down -1.61% year over year. The index is up 0.82% year over year.
- US inflation came in at 2%, up from 1.9% the month prior. Inflation has slowed considerably from the 2018 peak.

Equity Markets

- The VIX was up over 24% for the week.
- Equity markets were under pressure with the S&P 500 losing over -2%. Emerging markets lost over 5%.
- The Vanguard Total World Stock Market ETF (VT) was down -2.45%.

Factors

- Low volatility was the strongest factor last week. Momentum and quality also outperformed the S&P 500.

Sectors

- Consumer staples was the strongest sector last week.
- Technology was the weakest with semiconductors pulling the sector down, dropping almost -6%.

Intermarket

- Copper fell -2.04% against Gold last week.
- Stocks dropped against Bonds and Gold.
- Lumber gained against Gold, climbing over 2%.

Fixed Income, Commodities, Currencies

- The US 10 year yield lost 7 basis points, finishing the week at 2.47%.
- The 10 year minus 3 month Treasury curve flattened to 4 basis points.
- Long-term Treasuries were the strongest segment of the bond market.
- The CRB commodities index was down -1.55% last week.
- The Japanese Yen continued to rally last week, showing a deflationary impulse.
- Bitcoin is over $7000 as of Sunday night.

Chart of the Week: Valuations suggest low future returns. Buy and hold investing should suffer if history is any guide.

Chart 2: Inflation has picked up recently but is still below the peak. It is in a downward trend.

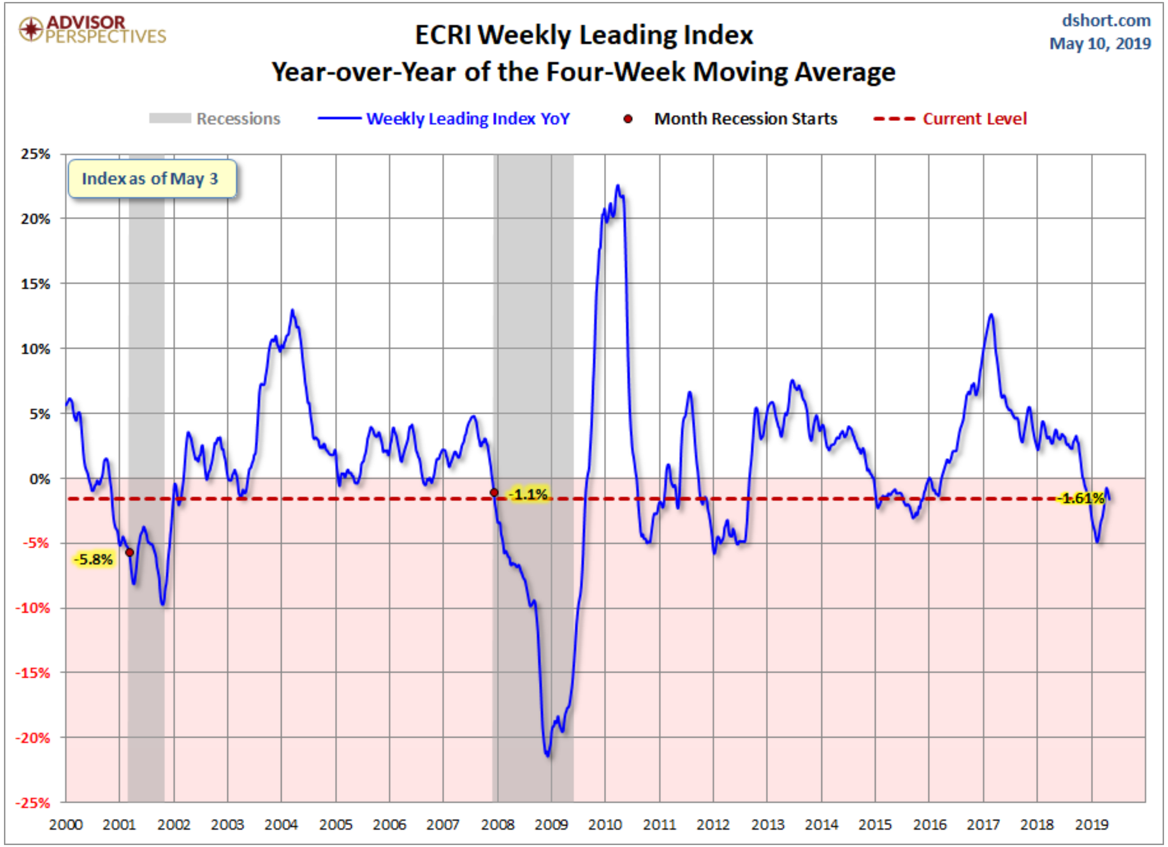


Chart 3 - ECRI WLI year over year of the four-week moving average is down -1.61%. This is suggestive of weakness in leading indicators, and it is not good for the US economic growth outlook.

MARKET SUMMARY

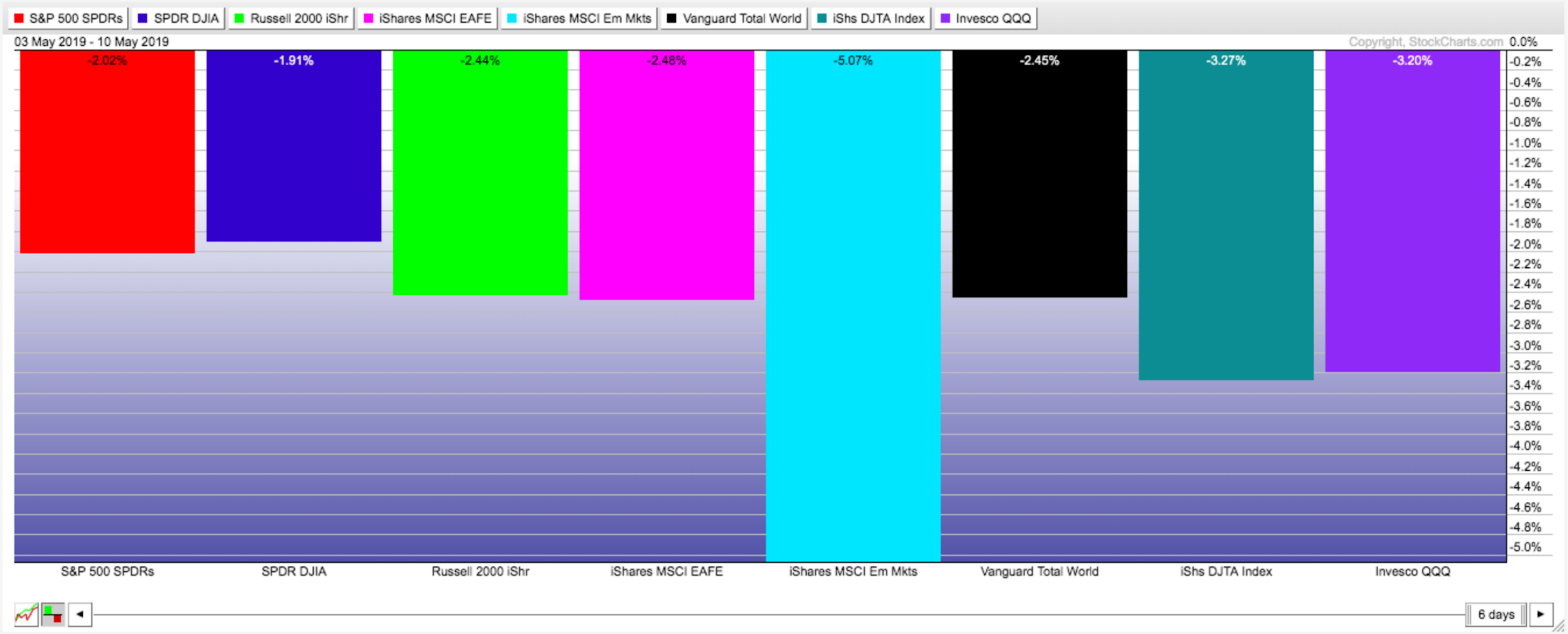


Chart 4 : Stocks were negative last week with Emerging markets down the most (EEM:-5.07%). The top performing segment was the Dow Jones (DIA: -1.91%).

SECTORS

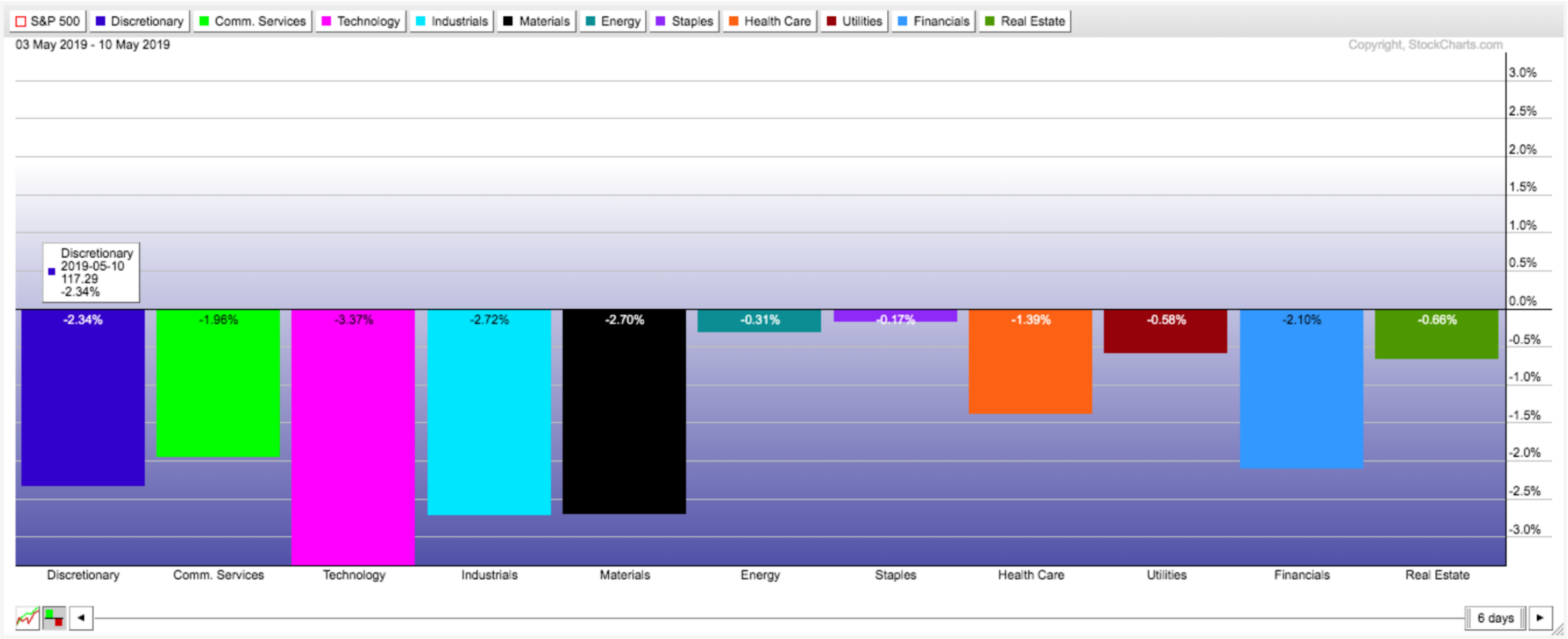


Chart 5: Consumer staples were the top performing sector last week (XLP: -0.17%). Technology was the worst performing sector, down -3.37% for the week.

FACTORS

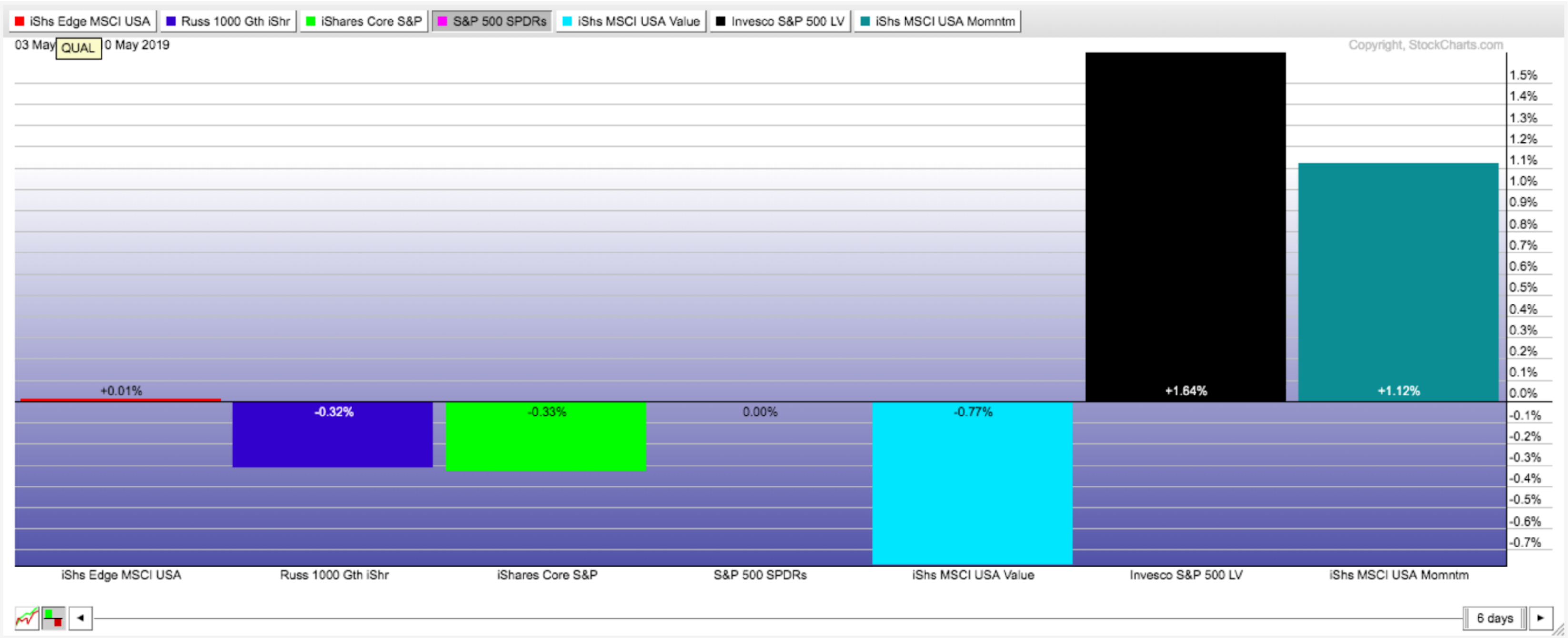


Chart 6: The top performing factor was low volatility last week, gaining 1.64% against the S&P 500. Momentum and quality outperformed the S&P 500 as well.

BONDS

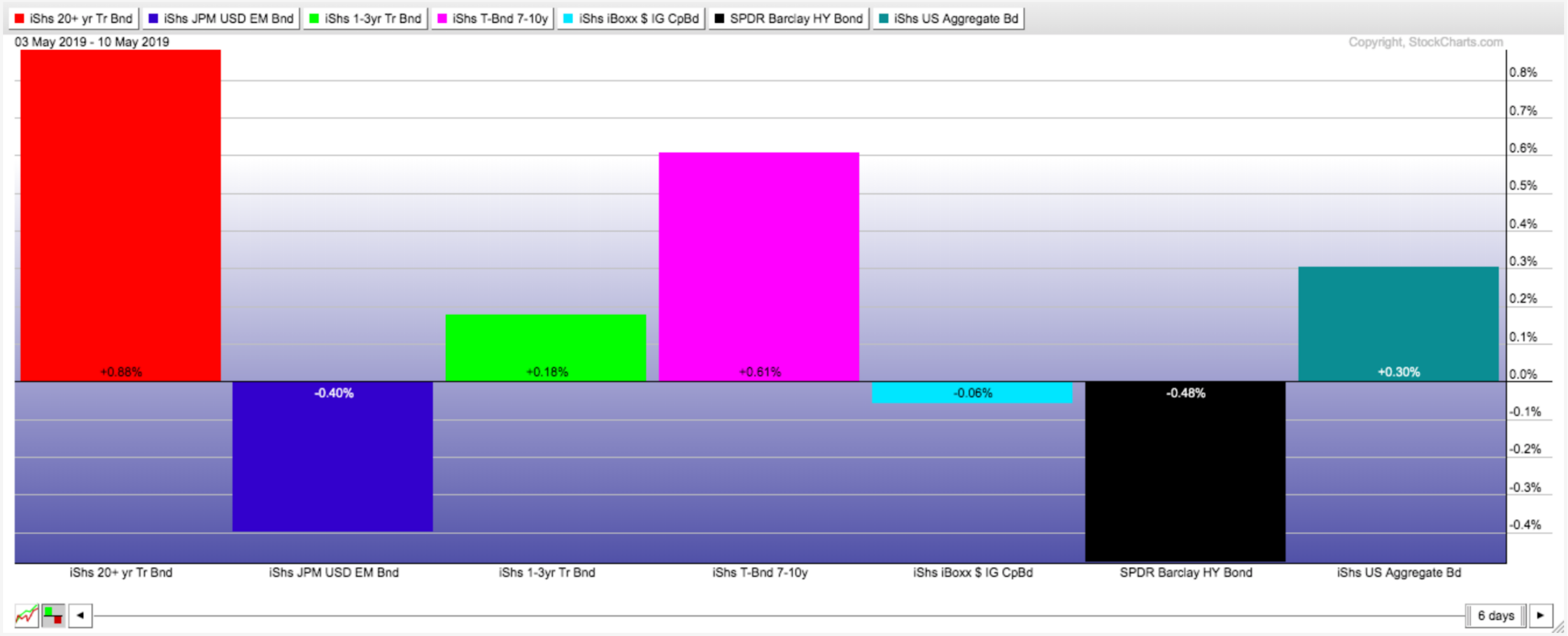


Chart 7: Long-term Treasuries (TLT) were the top performing fixed income segment as interest rates fell 7 basis points on the 10 year yield. High Yield bonds dropped -0.48% (JNK) as risky assets fell under pressure.

COMMODITIES & CURRENCIES

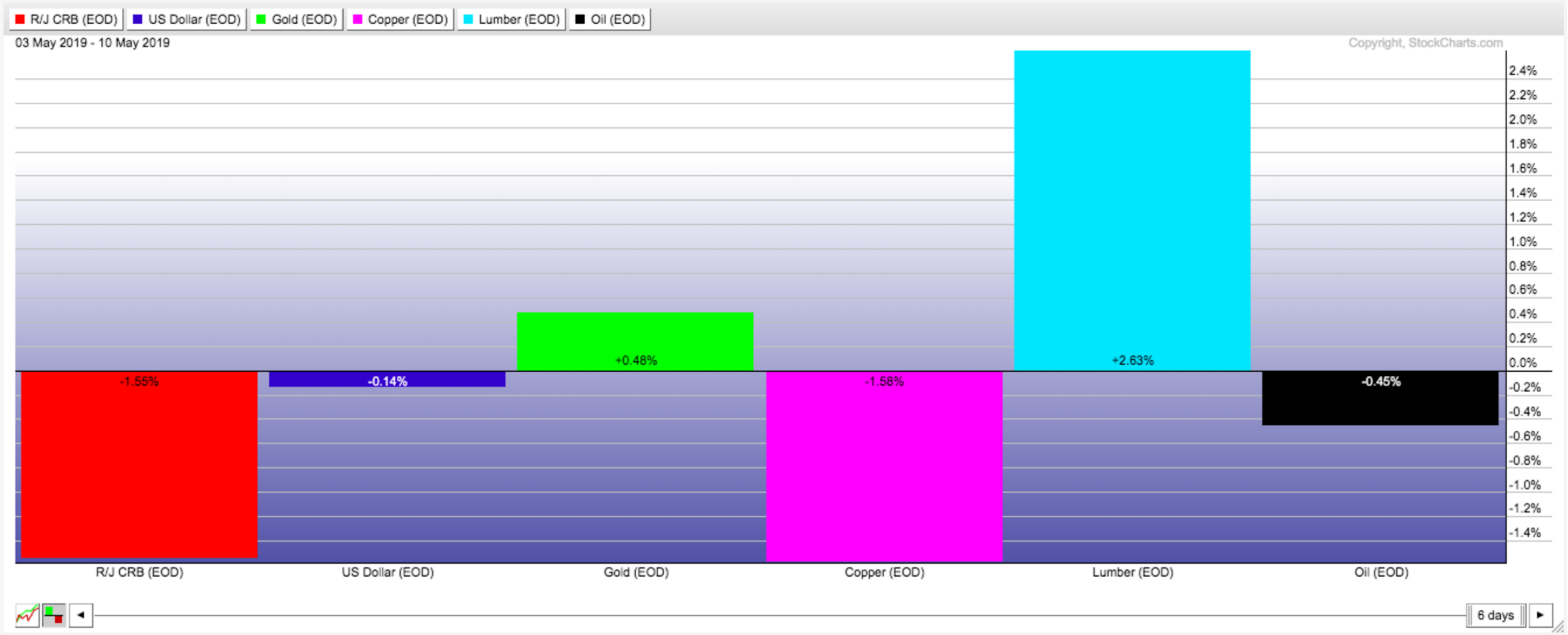


Chart 8: The commodity index fell -1.55% last week. Copper led all losers, dropping -1.58% for the week. Lumber was the top gainer, up 2.63%. Gold also gained as the dollar dropped -0.14%.

Chart 9: VIX gained 24.63% last week and momentum is starting to improve. Could volatility head higher?

Chart 10: Emerging markets fell last week. They rejected the top resistance band in their range. Are they headed back down to support?

Chart 11: Low Volatility rallied 1.68% against the S&P 500. It bounced off support and is showing positive momentum.

Chart 12: The consumer staples sector continues to demonstrate strength and is in a strong positive trend.

Chart 13: Stocks fell -3.04% against Treasury bonds last week. The ratio failed at resistance and momentum is breaking down.

Chart 14: Copper continues to break down against gold. It was down another -2.04% last week.

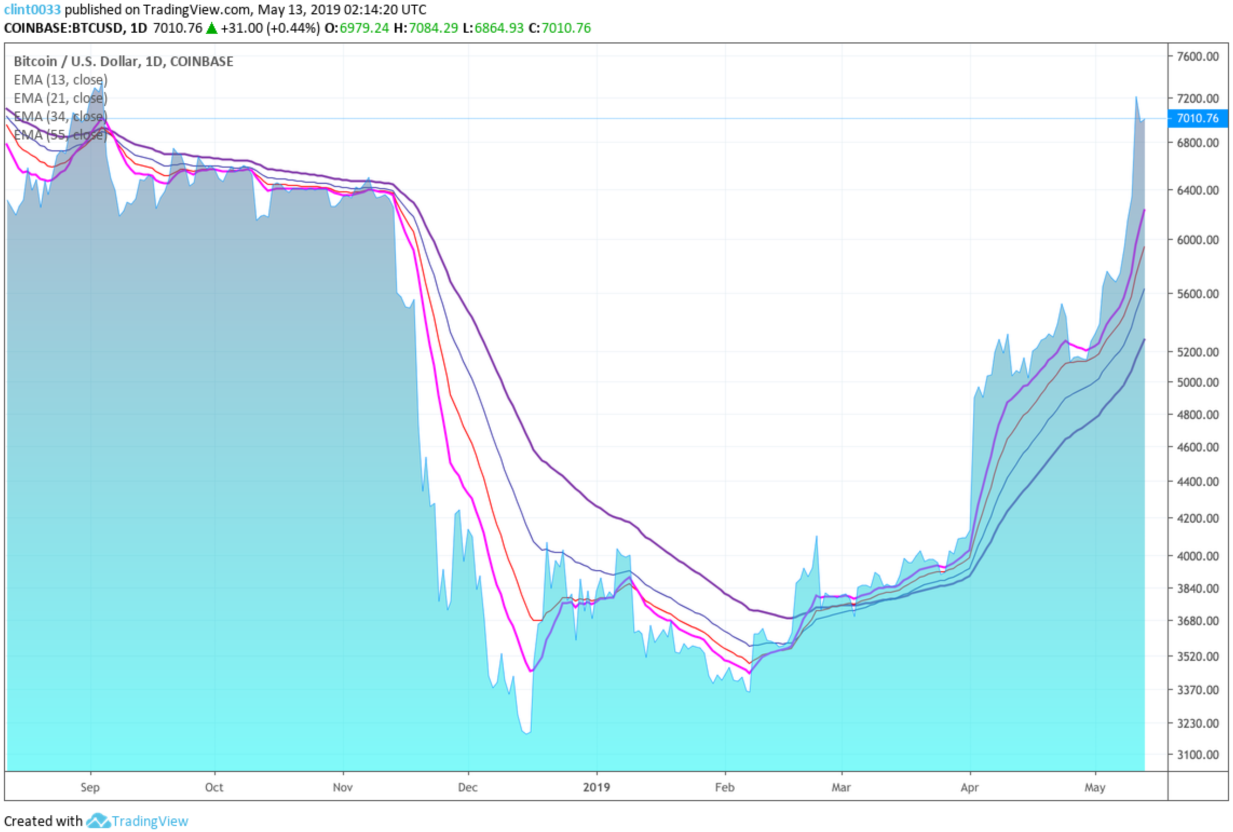


Chart 15: The Bitcoin and crypto surge continues as Bitcoin was over $7000 as of Sunday night.

Chart 16: Lumber rallied last week. Could this mean that equity market volatility is only temporary?

Chart 17: The Japanese Yen was up 0.75% last week against the Euro. The breakout is suggestive of a risk off move.

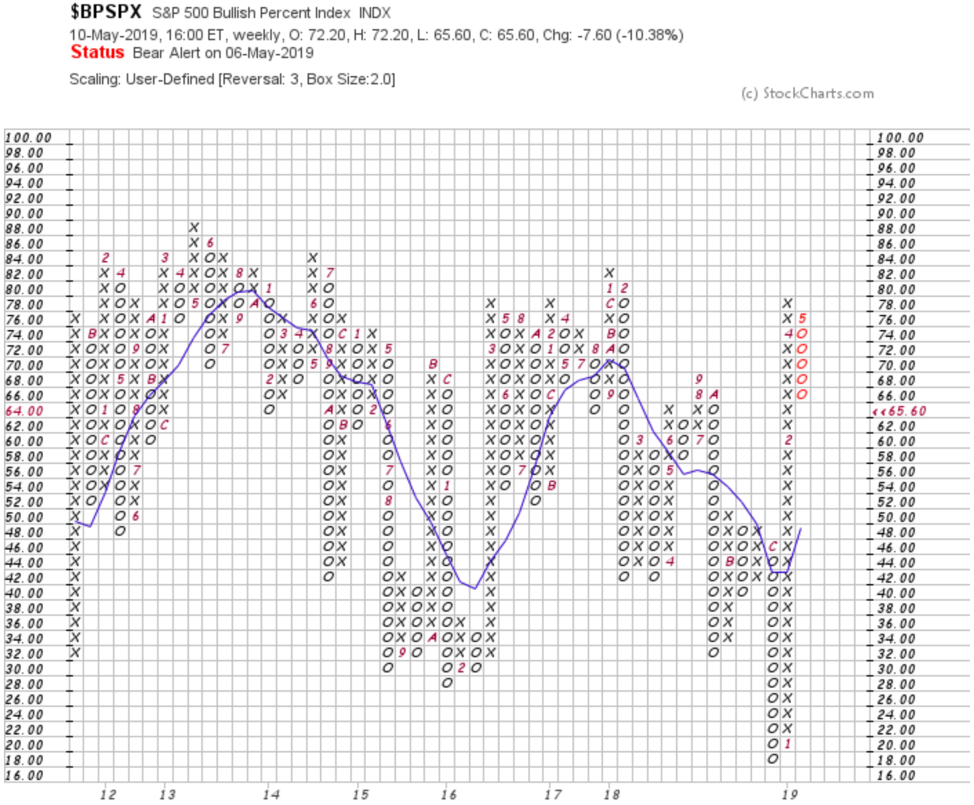


Chart 18: The Bullish Percent index for the S&P 500 has rolled over into a column of O's, suggesting that market internals are weakening.

SUMMARY & PLAYBOOK

Confirming Evidence of a continued rally:

- ECRI WLI is up 0.82% year over year.
- US stocks are in a positive trend relative to Gold (intermediate).
- Global stocks (FTSE all World with US) are in a positive trend relative to the risk free asset.
- Lumber rallied last week.

Non-Confirming evidence of a continued rally:

- The ECRI four week average is still negative year over year (-1.61%).
- Copper continued to break down against Gold.
- Small Caps relative to large caps are below the 2018 low.
- The Yen continues to strengthen.
- High yield is falling relative to long-term Treasuries.
- The VIX rallied significantly last week.
- The Bullish Percent Chart for the S&P 500 has rolled over.

Overweights:

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

Underweights:

Credit, Momentum, Cyclicals, Small Caps, Developed

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