February Market Outlook

Bullish Case

- The consumer is the largest part of our economy, about 70%, and they are buying at stores, online, and the buying includes cars. This is keeping our economy in a growth mode.
- Interest rates, inflation and oil prices remain low, and are good for the economy and asset prices.
- Stocks and the markets are now fair to undervalued

Bearish Case

- China and the global economy are slowing
- China's slowing and change of focus from investment, manufacturing and exports to a consumer and services focus are causing disruptions in the Chinese and global economies, especially resource based economies and countries.
- Growing concerns about Europe's slow growth, bank reserves, and the refugee crisis
- Isis and the Middle East create uncertainty, instability and danger
- Global terrorists' threats
- Earnings continue to be revised downward
- Earnings and economic growth continue to contract, so does the market P/E
- Global central banks, and especially ours, are running out of effective bullets to help our economies, especially if we have a global recession or financial crisis
- We are starting to see headlines of a potential global recession
- The collapse in oil prices is hurting many energy based economies (Russia, Mexico, Venezuela, Nigeria….). Low oil prices are also hurting the U.S. energy industry and we're seeing more layoffs, bankruptcies, and banks are worried about more energy loan defaults.
- Credit spreads continue to widen, (investors are selling low quality bonds and buying treasuries and safer debt) and are normally a reliable predictor of recessions.
- The technicals for the markets are bearish
- This economic and market cycle is maturing and may enter a decline phase (some indexes have entered decline, bear markets).

Earnings and P/Es Are Contracting

Each week I look at updated consensus earnings' forecasts for the Dow 30 and the S & P. I've been watching earnings forecasts being lowered. As earnings' forecasts come down, the growth rate of earnings comes down. As the growth rate comes down, then investors such as myself, will not pay the current P/E, so the P/Es, and valuations of the market and stocks fall.

Here is the trend for the Dow 30s consensus earnings forecasts:

	2015	2016	
5/18/15	1123.10	**1222.08**	**8.81%**
5/25/15	1123.24	1221.53	8.75%
6/1/15	1122.58	1221.41	8.80%
6/8/15	1122.75	1221.26	8.77%
6/15/15	1121.81	1220.11	8.76%
6/22/15	1122.19	1220.42	8.75%
6/29/15	1122.83	1219.92	8.65%
7/6/15	1123.55	1221.38	8.71%
7/13/15	1123.81	1220.24	8.58%
7/27/15	1107.74	1211.45	9.36%
8/3/15	1107.23	1207.46	9.05%
8/10/15	1101.28	1201.11	9.06%
8/17/15	1100.08	1201.28	9.20%
8/24/15	1099.19	1199.81	9.15%
9/7/15	1097.09	1195.57	8.98%
9/14/15	1095.51	1192.88	8.89%
9/28/15	1092.75	1187.47	8.67%
10/5/15	1085.38	1181.29	8.84%
10/19/15	1078.58	1168.22	8.31%
10/26/15	1075.23	1157.54	7.66%
11/2/15	1077.52	1158.18	7.49%
11/9/15	1079.28	1157.12	7.21%
11/16/15	1079.23	1158.06	7.30%
11/23/15	1079.36	1158.23	7.31%
11/30/15	1077.96	1156.54	7.29%
12/7/15	1078.99	1157.09	7.24%
12/14/15	1080.30	1159.38	7.32%
12/21/15	1079.37	1150.93	6.63%
12/28/15	1064.93	1149.12	7.91%
1/11/16	1089.60	1159.53	6.42%
1/18/16	1088.78	1146.61	5.31%
1/25/16	1096.96	1129.79	2.99%
2/1/16	1073.26	1111.57	3.57%
2/8/16	1073.11	1107.21	3.18%
2/15/16	1074.65	1104.99	2.82%
2/22/16	1075.43	**1100.07**	**2.29%**

Last year consensus earnings' forecasts for 2016 for the Dow 30 were has high as 1,222, about a 9% increase from 2015. Currently consensus earnings' forecasts have dropped to 1,100 and expected earnings growth as dropped to about 2.29%.

I'm waiting for earnings forecasts to stop dropping. The market can't find a bottom or stability as long as earnings forecasts keeping falling. This also means that growth rates are falling and therefore the amount investors are willing to pay for earnings (the P/E) keeps dropping. Investors aren't willing to pay a high P/E if growth is falling.

It's hard to come up with a target for the markets if earnings forecasts keeping dropping.

Many Indexes, Industries & Global Markets are in Bear Markets

Below is a table of the major domestic and global stock indexes:

INDEX	HIGH	CURRENT	RETURN	DATE OF HIGH	AVERAGE BEAR MARKET 30%
RUSSEL 2000 INDEX	1296	953.72	-0.2641	6/23/15	907.20
TRANSPORTATION INDEX	9310.22	6883.48	-0.26065	11/28/14	6,517.15
MSCI ALL-COUNTRY WORLD INDEX			-21		
NASDAQ	5210.16	4266.84	-0.18105	7/20/15	3,647.11
DOW 30	18350	15660	-0.14659	5/20/15	12,845.00
S & P 500	2132	1829.08	-0.14208	5/19/15	1,492.40
DIVIDEND ETF	81.5	74.22	-0.08933	12/29/14	57.05
UTILITY INDEX ETF	49.78	45.56	-0.08477	1/28/16	34.85

The RETURN column reflects returns from each indexes previous peak/high versus its current lows. The average bear market is down about 30%, the last column shows the price where each index would be down 30%.

The Russel 2000, Transportation and world indexes are in bear markets (bear markets happen when prices fall more than 20% from a previous peak). The world index would be down more if the U.S. was taken out.

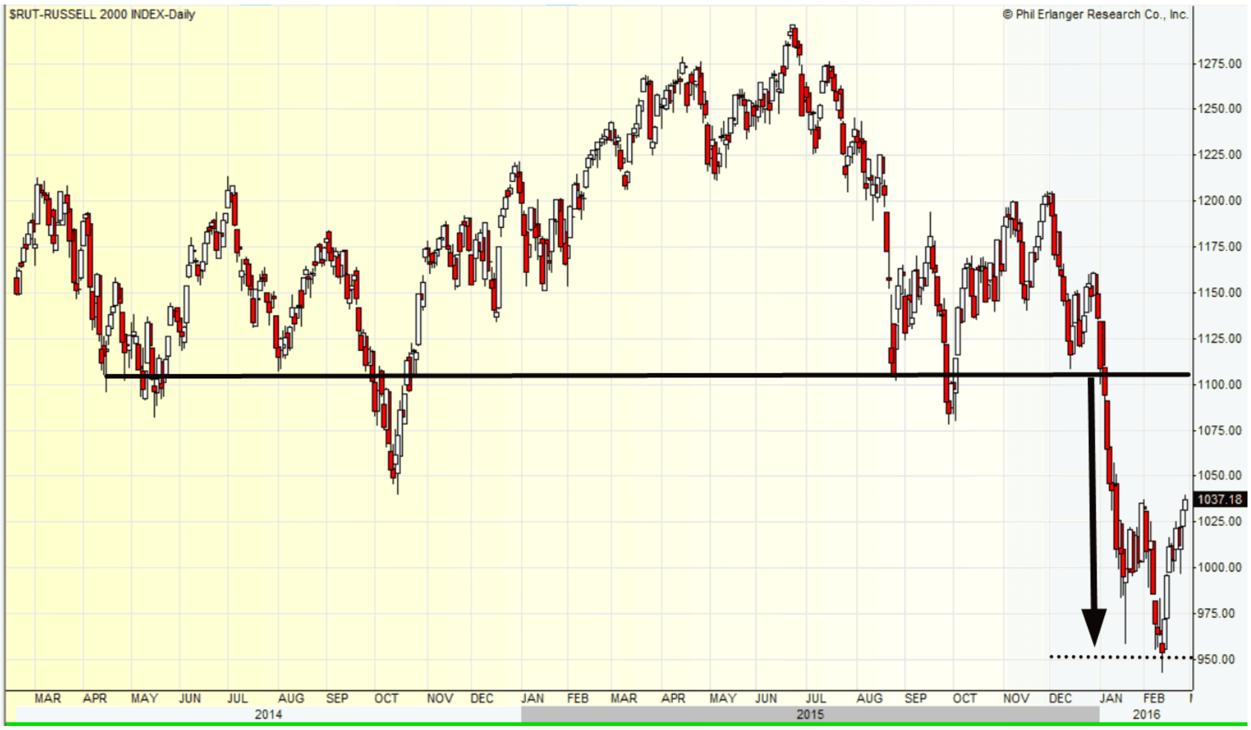
The NASDAQ, S & P and Dow 30 are not in bear markets, but are close. Historically, when prices are down by about 15%, there is a 58% chance that the bearishness increases.

Indexes with relatively high dividends are holding up better than the rest of the markets. Investors, including myself, are holding on to our dividend investments, especially if we bought them at much lower prices than today's prices. Dividend investors normally need the income from the dividends.

Technicals of the Markets

Because the economy and earnings are in question, determining valuations become more difficult. In times like this, it is useful to analyze the technicals (price analysis) of the markets.

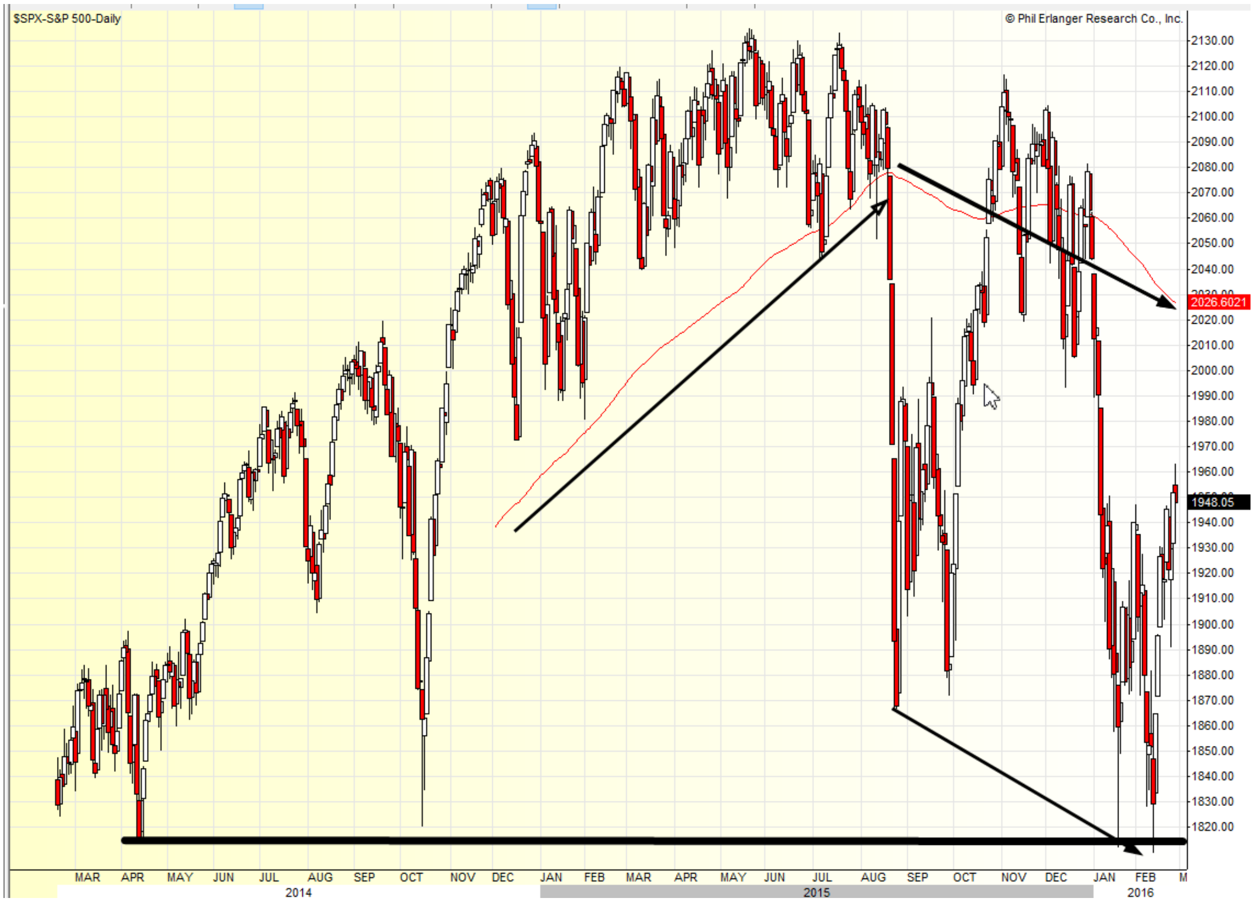
Below is a chart of the Russell 200 (symbol RUT):



The RUT was in a topping phase for close to two years. Prices finally broke support in early January. Breaking support created a sell signal, so prices broke down into bear market territory. The Russell 2000 was overvalued for the last few years. If earnings don't come down more, and if we don't go into a recession the RUT would be fairly valued.

If we go into a recession, we could expect the RUT to experience more downside.

The Dow 30 and S & P have not broken down like the RUT and many indexes. Below is a chart for the S & P 500:



Let’s review the chart:

The 200-day moving average, red trendline, is a major long-term trend indicator. For most of last year, the 200 DMA was bullish, rising with a rising tops and bottom line.

Last summer, prices broke below the 200 DMA creating a sell signal. Prices were able to recover, but prices broke down again, with the 200 DMA has been trending downward since last summer, a bearish trend.

Also notice that the pull backs have gotten lower on the last two pullback, another bearish trend.

Major long-term support in the black trendline at the 1,820 level. If prices break support, then the index will break down similar to the RUT and other indexes.

As mentioned above, historically, when prices break down by 15%, the probability of the trend getting worse is about 58%.

I have been recommending caution:

- Raise cash to preserve your wealth, and to use the cash to take advantage of lower prices and valuations once the bearishness has run its course.
- Lower the beta of your stocks, portfolio

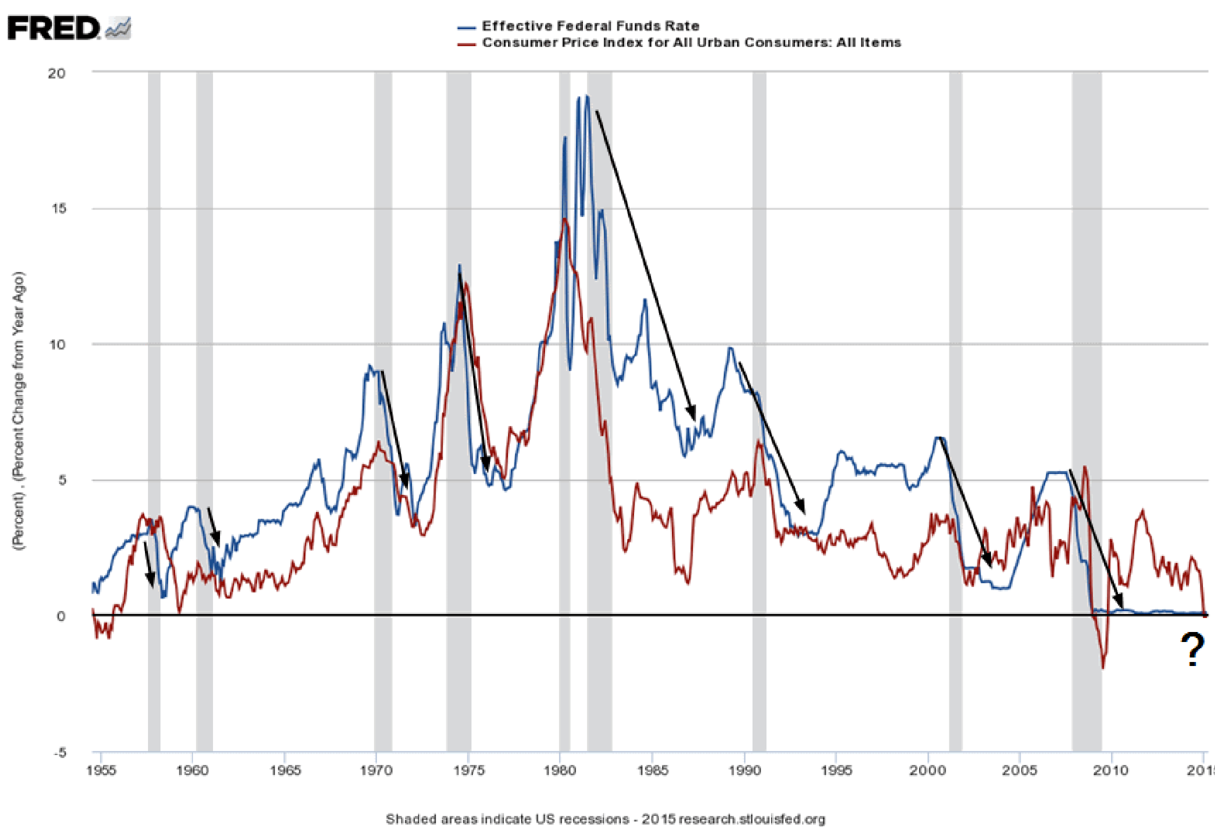
- Consider selling companies that have too much debt
- Consider selling cyclical and durable stocks
- Consider selling stocks that have high P/Es

I will wrote about the indicators and clues of when to start buying in future articles. We're probably at least 6 months away.

Here is what I wrote in my *February Economic Outlook*:

If we go into a recession, the Fed will not be able to lower rates to stimulate our economy. This means that a recession could last longer than most recession, rates can stay lower longer, and the market could struggle.

I also included the chart below to prove the above point.



The greay shaded areas are recessions. After each recession, the Fed lowered rates to stimulate the economy. With rates close to zero, the Fed will not be able to lower rates, the most effective tool the Federal Reserve has to stimulate the economy.

Be patient, bottoms take time to build, especially if we get into economic trouble and our Federal Reserve and other central banks will not be able to help the global, U.S. economy.