2018 July Market Outlook

According to one of my favorite investment books *Stocks for the Long Run* by Jeremy Siegel. "Billions of dollars of resources are spent trying to forecast the business cycle…but the record of predicting exact business-cycle turning points is extremely poor." What is ironic, one of the best indicators that economists have is the stock market. The market is forward looking. There is a lot to learn by studying price action and volume, otherwise known as technical analysis. The market reflects the consensus view of participants. As economic data is reported, the market adjusts. In this Outlook, I review the technicals/price analysis of this market, economic cycle.

As usual, I do list the bullish and bearish cases for the markets and my price targets.

Bullish Case

- At the beginning of the year there seemed to be weakness with consumers. Housing, autos, and retail sales were all lackluster. All three have improved the last few months.

- The economy continues to create more jobs.

- Investor, business, and consumer confidence remain high.

- Earnings are very strong this year thanks to tax cuts

- Tax cuts are also increasing stock buybacks, mergers and acquisitions, and dividends. All three could help stock stability and support.

- We could get a boost if there are positive results from the current negotiations with NAFTA, China, North Korea, Russia, Iran and the EU.

Bearish Case

- We have imposed tariffs against Canada, Mexico, China, and the EU. These countries have imposed tariffs against us. Many investors and analyst are very concerned that the tariffs could lead to trade wars. We also have sanctions against Russia, Iran, and North Korea. These fights with allies and foes could lead to a global recession.

- Providing tax cuts this late in the cycle is risky, especially when we have large deficits, debts and baby boomers applying for Social Security and Medicare en masse. This is one of the main reasons why many economists and analysts are not bullish long-term. I will explain this risk in my next quarterly economic outlook next month.

- We are shifting from stimulative monetary policy (ultra-low rates, and the Fed using its balance sheet to buy long-term bonds to lower long-term rates) to stimulative fiscal policies (tax cuts, government and military spending, trade policies). This transition has risks, especially if interest rates rise to fast, or not fast enough. As mentioned in the first bearish bullet point tariffs could lead to a global recession.

- We are seeing many red flags and signs we are in the late stages of this economic and market cycle:

  - Rising oil prices, inflation and interest rates
  - Full employment
  - Over to fairly valued markets, stocks
  - Narrow market leadership and market rotation (leadership often changes)
  - The market is developing a major reversal topping pattern (see technical section below).

- The dollar is stronger this year and it could be a headwind making our goods and services in foreign markets more expensive. Also, when the foreign sales are converted to a stronger dollar this will probably lead to currency losses that could lead to lower profits.

- Markets have been trading sideways for about seven months. The longer it goes sideways, the harder it will be for the markets to make new highs.

- The markets seem to be overlooking the Mueller investigations and the potential for more negative headline news including more indictments, and guilty pleas.

- Even though the economy continues to grow, headlines news is often negative, making it hard for the markets to break out of this trading range.

- There is a good probability that the Democrats could win the House in the November elections. This will make it difficult for President Trump to achieve the rest of his economic agenda. There could also lead to impeachment depending on the Mueller investigation's final report. Charges could include obstruction of justice, money laundering, tax evasion, campaign finance violations, lying, and conspiracy against the U.S.

- Black and grey events (low probability, but high impact) are always a risk.

The bullish and bearish forces will probably keep prices in its current trading range. As prices approach resistance (where prices tend to stall at the top of the range, and selling begins), valuations become expensive and prices no longer reflect the risks listed above. As prices fall toward support, the markets become more reasonably valued and they start to reflect the risks of the markets and creates a short-term buy signal.

Market Price Targets

Below are my price targets for the markets:

2018 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1534.61	16	**24,553.76**	24,907.21	-1.44%
SPX	153	17	**2,601.00**	2,792.31	-7.36%
2019 FORECAST					
	EARNINGS ESTIMATES	RISK,GRWTH ADJ P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1667.45	16	**26,679.20**	24,907.21	6.64%
SPX	162	17	**2,754.00**	2,792.31	-1.39%

Source: Barron's, Dan Hassey database

The markets are overvalued this year based on a moderate P/E and analysts' consensus earnings estimates for 2018.

The Dow has some upside for 2019. The S & P remains overvalued for 2018 if earnings forecasts are met and we use a reasonable P/E.

Next month I will analyze how analysts miss turning points in the economy, and earnings.

If you would like help valuing the stocks, investments you own, contact me at danhassey@yanoo.com.

Technical Review of this Market Cycle

We will review the technicals, price analysis, of this market cycle.

2009 to 2015

Source:www.erlangerchartroom.com

Let's review this chart:

- Around March of 2009 the S & P made a cycle low below 700.

- The market broke out of its basing pattern. Most basing patterns last about seven months. This basing pattern lasted about 8 months when prices broke out of its basing pattern convincingly in 2010.

  A basing pattern occurs at the bottom of a bear market and includes sideways movement, and a low being made. .

- In 2010 the markets stalled (price action in bottom rectangle). The markets were impacted by concerns about European sovereign debt and concerns about some European banks (some big European banks had sovereign debt on their balance sheets.

- Prices did double by 2012. This is why it's important to raise cash while prices are topping and values are expensive. Have cash at the bottom of the next cycle and start investing for the next bull market. Your money will normally double by year four just as it did this cycle from early 2009 to 2012.

- The market had a difficult time in 2011 (market action in second rectangle from bottom) and almost went into a bear market. The causes included: concerns about Grexit and the viability of the euro and the European Union; Japan's earthquake, tsunami, and nuclear plant crisis; the growing Middle East protests/ Arab Spring. Earnings did stall in 2012.

- The market took off after 2012 to 2015. The market tripled by 2015. Most of the gains for this cycle were made by 2015.

U.S. analysts and economists are very U.S. centric and forget about potential dislocations and disruptions from international events just as they did in 2010, 2012. In the next section, we see global events disrupt global economies and markets, including the U.S. in 2014 to 2016 The global events that can disrupt the global economy and markets that will could be reflected in our markets are many: North Korea, Brexit, Iran, global terrorist attacks, Venezuelan (important global oil producer, they have the most oil in the world) social and economic collapse. China could be a major global disruptor because of their slowing economy, huge and growing debts, trade issues including technology theft, and their growing military presence in the South China Sea.

The lesson for investors – PAY ATTENTION TO GLOBAL EVENTS.

2014 to 2016

The markets, earnings, and the economy stalled again from late 2014 to the end 2016. The cause – global events.

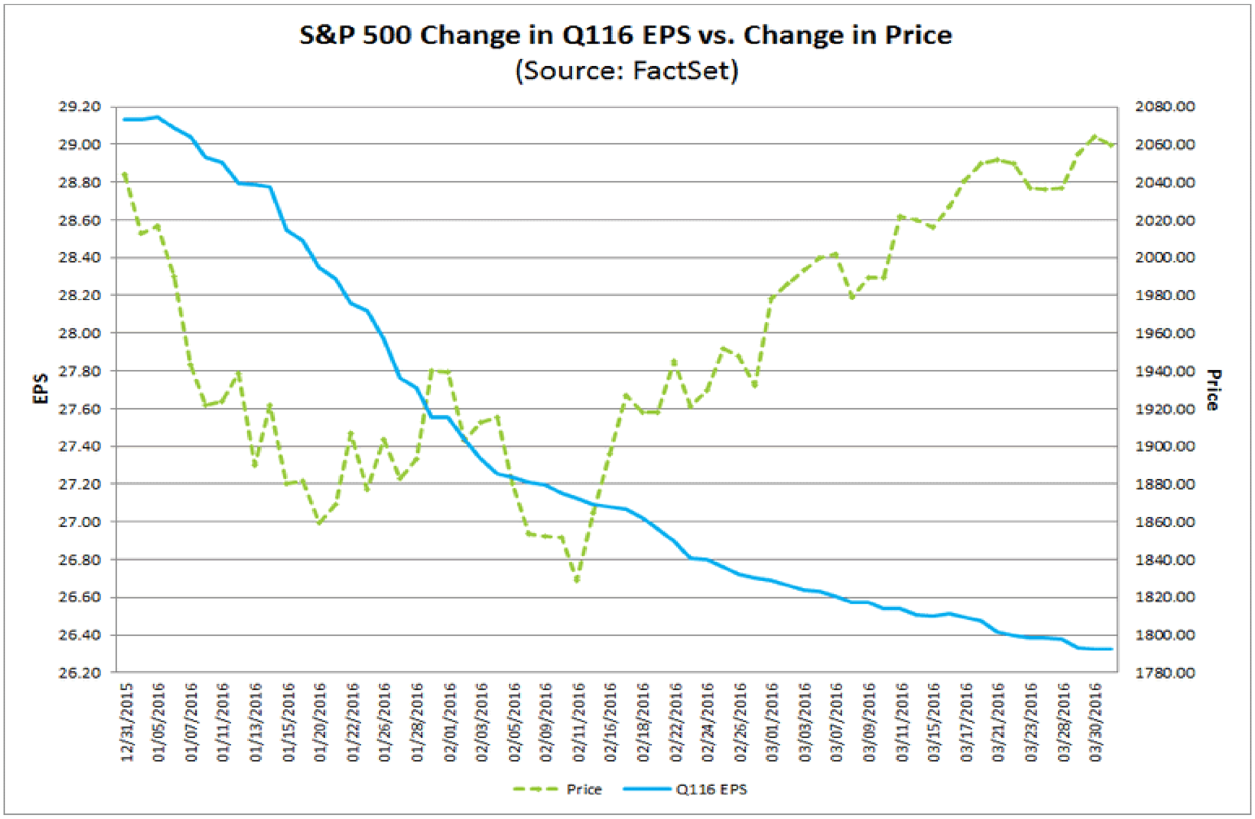
Below is a chart of the period:

Source:www.erlangerchartroom.com

Prices went sideways from the end of 2014 to the end of 2016.

During this period, China started an economic shift from an investment, manufacturing, export driven economy to one more like the U.S. where the consumer is the most important component of the economy. Commodity prices collapsed during this shift, for example oil prices dropped from over $100 to less than $30. Many countries (Canada, Australia, Brazil, Mexico…) that supplied commodities to China for their manufacturing and building went into recessions, or saw their economies slow.

The chart below shows during this period earnings were falling but market prices stayed elevated. Also, P/Es expanded in 2015 from about 16 to 19 by the end of 2016.



Source: Factset

In 2016, I started to become bearish because of the weakness in the global economy, earnings were contracting, stocks and the markets became overvalued, and the topping pattern of the market is a sign of the late stages of an economic and market cycle. Here is what I wrote in July of 2016: "we are in the mature/topping, sell phase of this market cycle, and the strategy for this part of the cycle is caution." I was wrong. You can find the quote strategy on the first page. Click here to review the report.

I co-wrote a free technical analysis course and I explain the very import major reversal patterns. Learning about major reversal patterns is a key to successful investing. Click here to learn about major reversal patterns. You can also learn about basing patterns.

If you would like coaching with your trading and technical analysis, call me at 951-849-1218

2017, 2018

2017

Before the election in 2016, the markets started to tank because of the uncertainty of the elections and the potential for trade wars if Donald Trump became President.

The day after the elections, many members from the President's economic team went on the financial cable news touting the new administrations new economic agenda. It worked and markets took off.

Below is a chart of the market for 2017, 2018:

Source:www.erlangerchartroom.com

Last year a lot went right for the markets:

- Investors and businesses were enthusiastic regarding the new President, his economic agenda and economic team. Investor, business and consumer confidence, increased.

- Investors were optimistic about the prospects for tax cuts, infrastructure spending, deregulation, and bringing back jobs from Mexico and China.

- Commodity prices recovered, especially oil prices, and so did the countries that supplied them. Energy and other commodity producing companies and their earnings hurt the markets in 2015, 2016, but helped the markets in 2017, 2018. Energy industry earnings had the best growth rates in 2017, 2018.

- The markets broke out to new historic highs in late 2016. Once prices break to new highs, most of the resistance and supply is gone, and it will be easy for prices to continue to make new highs and this is what happened for much of 2017 and is one of the main reasons for the markets strength.

- Investors were buying the dips, not allowing stocks, the markets to fall too much.

- The dollar was weak helping exports and earnings for U.S. international companies.

- There was speculation on the upside based on the acceleration of the price trend. We see that prices created a pattern called fanning (dotted trendlines) where prices accelerate from the long-term trend line, black solid line. Prices normally will fan, accelerate four to five times and the trend tends to reverse, or stall.

- When prices move almost 90% degrees, the trend is not sustainable and the trend will be easy to reverse.

I was bearish in 2016 for the many reasons listed above in the 2014 to 2016 section. I was essentially right about 2017 and the ability of the markets to march higher, here is what I wrote in February 2017:

- "Once prices move above resistance and new highs are made, it is easy to continue to make new highs. Resistance is basically where previous investors and traders bought and are a potential supply of stock, resistance. Once prices move above resistance that supply, sellers are gone and there is little resistance, selling left.

- Once prices break above a new resistance and makes new highs, prices will normally move about 3% to 10% above resistance. So far, the market is about 3% above the resistance of 20,000.

- Round numbers can also be the new resistance. In this case that could be 21,000.

- Breaking resistance and making new highs creates a buy signal. Also, trend followers and momentum players jump on the trend and the upward trend goes parabolic. It's normal to continue to make new highs once the old highs are breached and the supply of sellers are taken out."

Click here to review the February 2017 Market Outlook. The text above is near the end of the Outlook.

2018 Price Action

Let's focus on the price action in the rectangle.

The markets were able to continue to make new highs at the start of 2018. But, as mentioned above, the parabolic move was not sustainable and the upward trend was easy to reverse.

It is normal that once the trend has reversed, a new resistance and trading range develops, especially after a major advance like we had last year. There are many bullish and bearish crosscurrents that are helping keep the markets in the current trading range that are listed in the bullish and bearish sections above. I've been right, so far, that the markets would trade sideways. Here is what I wrote in February of 2018:

"A lot of damage has been done. There is supply, sellers who bought at 25,000, 25,500, 26,000, 26,500, and also those that have profits will probably sell at higher levels. It will take time and lots of money for prices to reach the old high, or to make new highs.

So what will probably happen to the markets going forward?
We have probably found a short to medium-term bottom. It's earnings season, and earnings are strong, so it's possible that prices could test the old high and maybe even make new highs.

If prices don't recover to its old highs, prices will probably trade between the high of about 26,500 to support 23,700, making a topping formation, the last stages of a market cycle." Click here to read the 2018 February Market Outlook. The comment is close to the end of the Outlook.

Since last November, the markets have been stuck in this trading range.

The markets have a chance to make new highs this earnings season as earnings are expected to grow about 20%. If the markets don't make new highs this earnings season, then the next attempt could be in November when the markets normally start adjusting to the prospects for the following year. Also, if the market continues to trade sideways the resistance will get stronger and it will be more difficult to breakout to new highs.

Some of the bearish events, issues listed in the bearish section could end this long economic and market cycle.

Summary and Conclusion

- There are bullish and bearish cross currents that will probably keep this market in it's trading range that started last November. Below are the main bullish and bearish catalysts:

Bullish: Strong earnings, job creation, positive business, consumer and investor confidence, the economy has improved since the slow start of this year, many companies have announce stock buybacks, increased mergers and acquisitions, dividend increases

Bearish: tariff and trade war concerns, growing deficits and debt, late phase of this cycle, negative headlines, shifting from monetary to fiscal policies, rotation in the markets, a rising dollar and its impact on exports and profits, elections and the potential for a Democratic house, Mueller investigation and its final report, international corporate profits, rising inflation, interest rates and oil.

- Economists and analysts are bad at predicting turning points in the economy and markets. Ironically, one of the best leading economic indicators is the stock market.

- Technical/Price analysis can give us better clues to what investors are anticipating. Some of the lessons we have learned: pay attention to global events, the markets are currently providing red flags, once prices break to new highs, prices will probably continue to make new highs, it looks like the current trading range may could be a major reversal pattern and is a red flag, parabolic moves are not sustainable.

- The market's last high was made in January. It has a chance to make a new high this earnings season and in November. If a new high is not made resistance/the supply of selling will grow and breaking to new highs will become very difficult.

- I got the market wrong in 2016, but basically got it right in 2017 and 2018.

Predicting the market and economy accurately and consistently is impossible. As investors, it is best to invest when valuations are low, and at the start of a new cycle and sell or hedge when valuations are expensive and after a long bull market. At this point, be cautious, patient and disciplined.

If you need help with your portfolio, or need coaching with your investing and trading, contact me at danhassey@yahoo.com, or 951-849-1218.