2019 April Market Outlook

Here are my 2019 Market Outlook comments made in January "Most analysts see more volatility in the markets as headlines will be a mix of good and bad news." This has been basically correct, but instead of the markets reflecting good and bad news, the market tends to ignore bad news and rally on good news.

Last month I focused on the technicals of the market, this month we get back to my normal analysis of the markets: the bullish and bearish case, valuations, psychology of the markets and the technicals.

Bullish Case

- The U.S. economy continues to exhibit growth and create jobs.
- Inflation is behaving.
- Interest rates have stopped going up
- The trend is your friend. The upward trend of the market is attracting trend followers, momentum players and high frequency traders. The markets have been able to rally through important resistance levels.
- Some analysts believe that money is coming off the sidelines as some money managers need to get their performance up and FOMO (fear of missing out) of the current bull market.
- The financial cable channels have many bulls sharing their bullish perspective helping sentiment in the markets.
- Most investors believe that the Fed will stop raising rates and the "Fed put" (if the economy or markets falter, the Fed will come to the rescue and lower rates) is back.
- Most investors believe there will be a China trade deal. Any deal will do as it will reduce the uncertainty that permeates the global economy.
- Earnings estimates for 2020 are out and some analysts see double digit growth for next year. See valuation section below.
- 401k investors and financial planners are providing automatic buying of equities and debt helping the rally, for now.
- Many investors and analysts believe the economy and earnings will improve the second half of the year.

- A few high profile Wall Street analyst believe the market should be between 2900 to 3100, based mostly on using a higher P/E multiple. Participants seem unwilling to leave the market, in other words they are not selling. Participants are buying any type of pullbacks.

- If the markets break through the all-time highs of last year, the markets could rise more due to no supply and resistance that translates into less selling, similar to 2017. Breaking through all-time highs could be a buy signal among speculators.

Bearish Case

- The markets are expensive. See valuation section below

- The market have gone up too far and too fast. A sign of speculation. See Technical Analysis section

- Leadership keeps changing (risk off to risk on, technology to dividend payers, financials to energy).

- Most analysts, and economists agree we are in the late stages of this economic and market cycle.

- Serious risks are rising outside our borders: Venezuela, North Korea, Iran, China, trade wars.

- The global economy is slowing. China, Germany, France, Italy, Japan, South Korea are all showing signs of slowing. Brexit has been kicked down the road, the latest extension is until October.

- Earnings estimates have been falling for the last few months

- Most of the markets rise this year has to do with rising P/E multiples and not growth. See valuations section.

- The Mueller report is out, but it’s not the end of the Presidents legal and political problems. There are over 20 criminal investigations and more investigations from the Democrats in congress. These investigations will continue to be distractions for the President and his administration.

- The dollar remains strong and could hurt earnings and trade.

- Much of the markets rally is based on news announcements of the Fed not raising rates and progress with China trade negotiations, and the belief that economic and earnings will get better the second half of the year. Rates have moved up 9 times since 2015 and were close to reaching their targets, so the move in the market because of the pause in rates is not justified. The longer it takes to reach agreements with China, the more damage is done to the global economy. The latest China news is a final meeting may occur in June.

- Growing deficits will probably get worse and may be headwinds going forward

- Crowded index funds may cause problems for investors if they all try to head for the exits as the economy and earnings slow.

- President has too many balls in the air (China, North Korea, Russia, Iran, Venezuela, U.S. economy, immigration, healthcare…) and the mishandling of these important issues is possible.

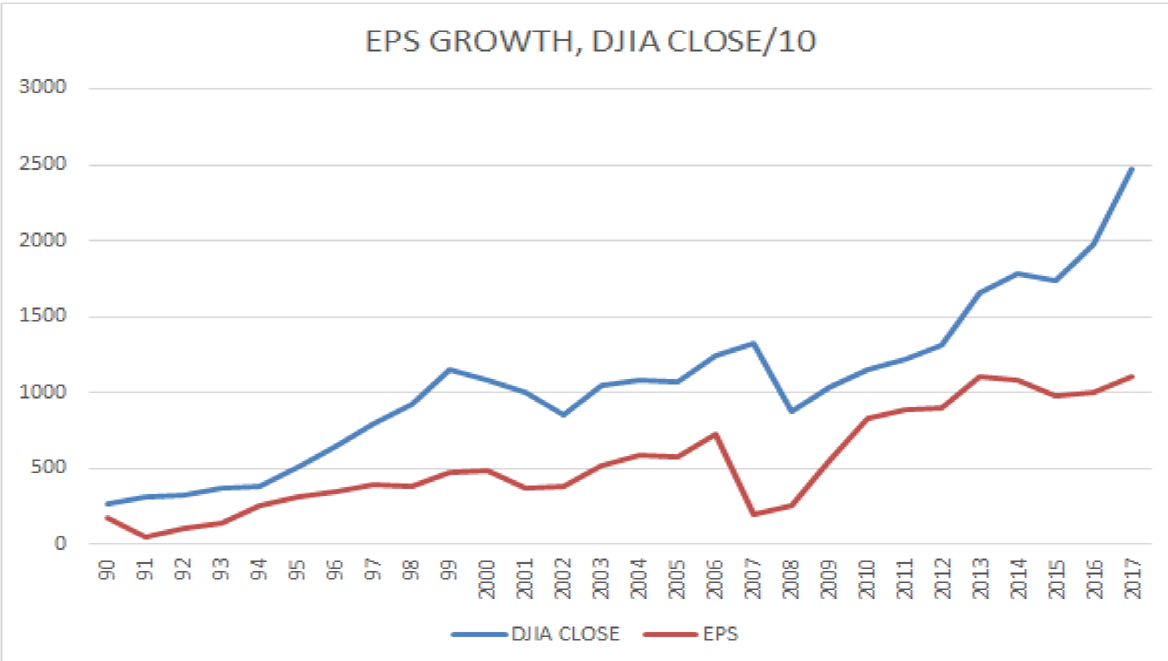
- Black or grey swans

- Several prominent economists have talked about the problem when we do go into a recession we won't have the normal tools of lowering rates and government spending and cutting taxes. Rates are too low and we've already cut taxes and increased spending so monetary and fiscal efforts may not be effective.

Valuations, Market Price Targets

Investors need to protect the purchasing power of their investment dollars and the best way to do this is to invest in assets that are appreciating faster than inflation. Company earnings and business growth is a good way for investment dollars to be invested when earnings, the company's fortune are growing faster than inflation.

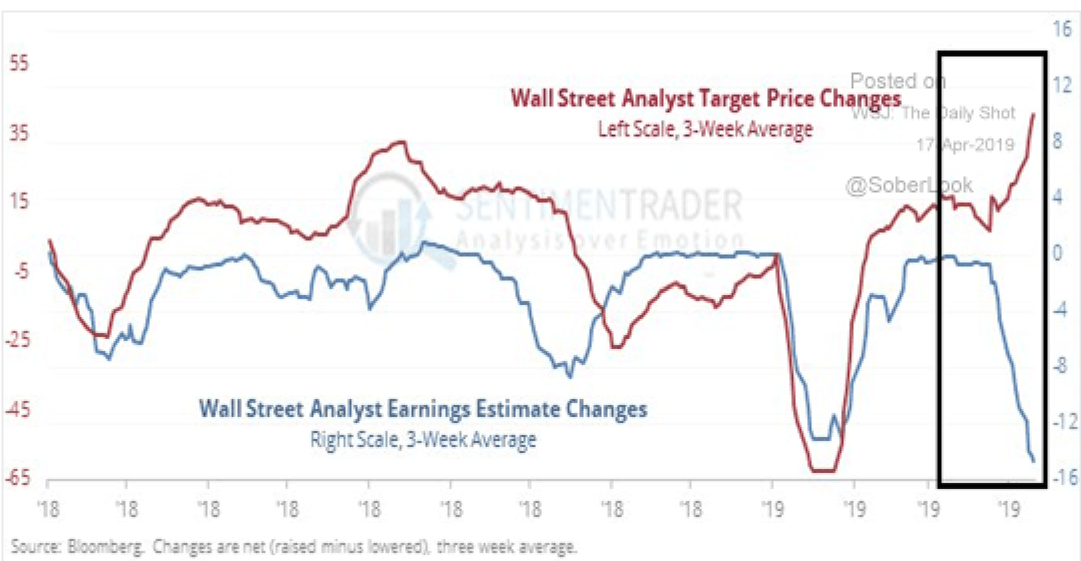
The chart below shows the relationship between earnings growth and stock prices.



Source: Dan Hassey database

The chart shows the close relationship between EPS, earnings per share, and the markets. When earnings are growing, then the market moves up and vice versa (see 2007 to 2009 period when earnings and prices were falling).

Lately this important relationship has decoupled. Notice the last two years where the market was moving up faster than earnings. Here is a current chart of EPS and the markets:



The chart shows that price targets have significantly diverged from earnings estimates. Even though earnings estimates have been coming down analysts keep raising their price targets. In many cases, it the parabolic moves in prices is causing some analysts to increase their price targets so they don't look out of step with the market.

When a company wants to sell itself or buy another company valuations are the way a price is determined. The markets will eventually get back to the fundamentals, and logical valuations.

Currently, investors are more interested in stories about companies and the market and aren't concerned with the fundamentals and valuations of a company. This happened in the late 1990s and the tech bubble where investors focused on stories and not the fundamentals of a company.

Below are my current market targets:

2019 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1632.19	15	**24,482.85**	26,597.05	-8.64%
SPX	171	16	**2,736.00**	2,927.25	-6.99%
2020 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1832.30	15	**27,484.50**	26,597.05	3.23%

Source: Thomson Reuters, Barron's

Using a moderate multiple and current earnings forecasts, The Dow 30 and S & P are both overvalued. Earnings for the Dow 30 were as high as 1720 last October and have fallen to 1632. Earnings are out for 2020 and the forecast is to grow double digit. I would expect 2020 earnings forecast to be adjusted downward, this would be normal this late in the cycle. Positive earnings forecasts for 2020 is another bullish case for the markets.

Earnings are expected to be up about 4% to 6% for 2019, but the markets are up of 15%, for now. Since 2016 the stock market has been stronger than earnings, except for last year when growth was great but the market was down about 6%. The markets have been unusual the last few years. The technicals make more sense when explaining today's markets. That is why last month's report focused on the technicals, price action of the markets.

Here is the other side of the bullish view, if the economy does strengthen in the second half, then rising interest rates are back on the table, or what happens if weak global economy impacts us more, what if the China deal falls through or takes more time or is a bad deal for the U.S.

Psychology of the Markets

Traders and some investors have been bullish so far this year, they believe: rates will stop going up, there will be a China deal, the second half of the year will be better than the first half, the U.S. economy is the best economy in the world, and similar to the technology boom of the late 1990s and early 2000s, technology is the place to invest and ignore the valuations.

Price and Technical Analysis

Since the market seems to be ignoring bad news, valuations and fundamentals, let's look at the technicals. Here is a current chart for this market:

Source:erlangerchartroom.com

I use the S & P 500 ETF because it has volume data. I explain this chart below:

- The current market's support and resistance levels go back two years, in other words the markets have been stuck in a trading range. For the S & P, support is around 2350 and resistance is around 2930.

- When a bull market is in its final stage, a market will build a top, called a major reversal top. Most tops take about thirteen months to develop. Next month the top will be two years old. A major reversal top is a reversal of a bullish market, turning into a bear market.

- The next three bullet points I divide the chart into its three rallies

- The first rally lasted for most of 2017 and accelerated on the news of the prospects of tax cuts. Tax cuts were passed at the end of 2017. The markets rallied on the news in January 2018. When you see prices go parabolic as they did in January 2018, it is normally a sign of speculation. Labor costs started to increase and this spooked the markets and a selloff began.

- The markets tested the low in late March and the next rally began

The second rally was not parabolic and it was able to move above the historic high made in January, the first rally. There were several clues that told me that the rally above the historic high was suspect. 1. After price broke to new highs, the length of the rally after the breakout only lasted a few days and prices pulled back to support/resistance line. 2. Volume was declining, money coming into the market. See bottom pane and black line showing volume was low. 3. A true breakout normally rises at least 3% the previous high. The move was only about 1.3%, very weak move. The market tried to rally again, but the red candles indicate more selling than buying as prices ended near the low of the day. Concerns about slowing global growth, trade wars, slowing housing and auto sales, the potential for more rate hikes, oil prices hit a four-year high, earnings estimates for 2019 started to be adjusted downward, and prices starting falling below important support levels including support at the 2575 level, breaking the 50 and 200-day moving averages. Prices finally found a bottom in late December.

- The third rally, current move, is a rare v shaped recovery based on the hopes listed above (rates will stop going up, there will be a China deal, and the 2nd half of the year will be better.) Another parabolic move where price momentum is more important than valuations and fundamentals. It's possible that prices make a new high. When prices make a new high, then normally round numbers would be the next resistance about 2950 to 3000 or a 3% to 5% move above the old high, around 3020. If we don't get a China deal, the 2nd half doesn't get better, then a test of the low made last December is on the table. The volume, money coming into the market, with this rally is even less see bottom pane.

Summary and Conclusion

- The current rally is basically based on no more rate hikes, a China deal will be made, the second half of the year economic and earnings growth will be better.

- The market is ignoring the many geopolitical risks (Iran, Venezuela, North Korea), a slowing global economy, trade wars with Europe and China, slowing earnings, and most economists and analysts agree we are in the late stages of this economic and market cycle.

- The current rally is parabolic and parabolic moves are signs of speculation. If you're a speculator there are short-term opportunities, if you're a long-term investor and especially if you're retired or close to retirement, caution is advised.

- The market is probably building a major reversal pattern normally the last stage of a bull market.

If you would like help, a second professional opinion on your portfolio, holdings please contact me at the email below. I do provide a free two hour consultation including a technical, fundamental review of your key holdings. Contact me at danhassey@yahoo.com.