May Market Outlook

The markets continue to be in a topping phase where prices have been going sideways for almost two years. The sideways, topping phase is evident in most indexes and is a sign of the late stages of a bull market.

In my March Market Outlook I focused on the technicals, price analysis of the markets. The technicals continue to be important, so I also focus on price analysis in this month's Outlook. Below is a link to my March outlook:
https://theretirementinvestmenteducator.com/page/rie/monthlymarketupdate/2019-03-27-008.pdf
You can subscribe to the site for free, but you have to enter your email. You will probably get some spam, but hopefully you have a good spam filter. You can also email me and I can email you back an original PDF.

Also, as I anticipated at the beginning of the year, headline news would make the markets more volatile. For much of the year the markets tended to ignore bad headlines, and moved on bullish news. That is changing now; investors are now reacting to both bullish and also bearish news.

Bullish Case

- The U.S. economy continues to exhibit growth and create jobs.

- Inflation is behaving, for now

- Interest rates have stopped going up

- Earnings estimates are out for 2020 and analysts see earnings growth in the low double digits. See valuation section

- Consumer, business, and investor confidence remains high, especially among professional investors.

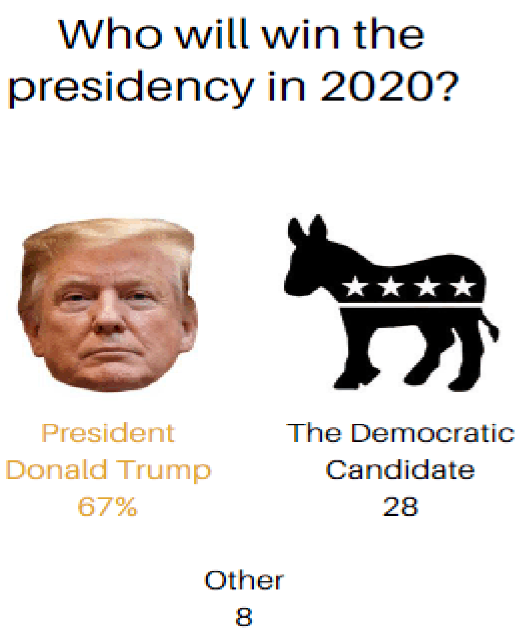
A few times a year Barron's does professional investor surveys. Below are two interesting surveys that corroborate the positive sentiment towards President Trump and is one of the reasons why this market has been strong the last few years.

1. How would you grade the performance of President Trump, the House of Representatives, and the Senate since the 2018 midterm election?

	Trump	House of Representatives	Senate
A	13%	1%	2%
B	28	7	13
C	22	32	37
D	20	31	28
F	17	29	20

Source: Barron's

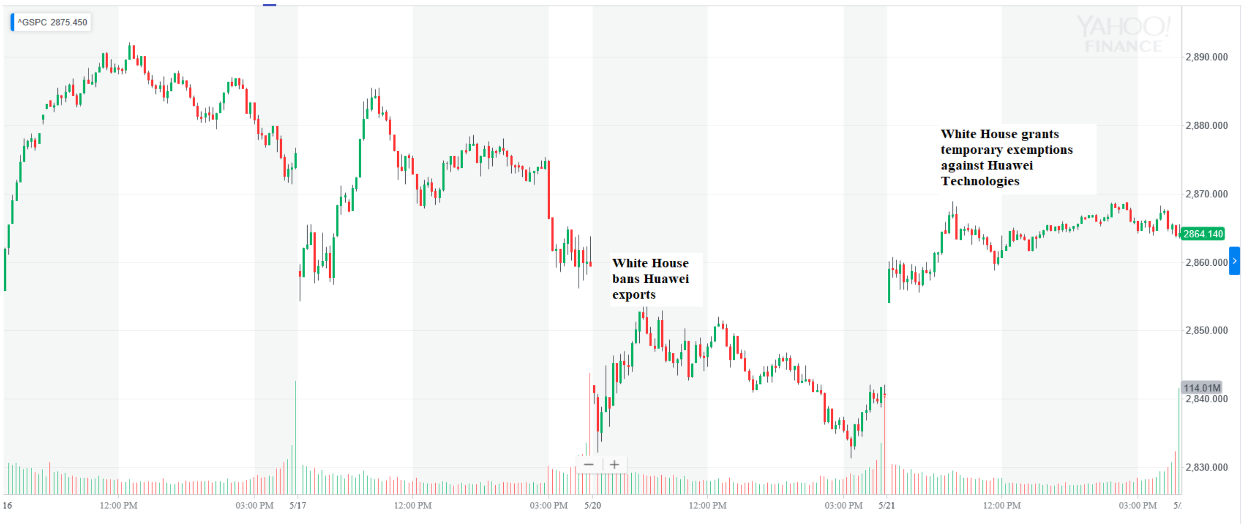
Most investors give the President a B.



Source: Barron's

They also overwhelming believe the President will win reelection.

- Some analysts and economists believe the increased U.S., China tariffs will have a lesser impact than most people believe. This analysis is being accepted by many investors.
- The market continues to react favorable to good news versus bad news.



On May 20, the Trump administration announces a ban on exports to Huawei, and the market and especially tech stocks fell. The next day the administration announces temporary exemptions and the market more than makes up for it. Again, the markets continue to react favorably to bullish news.

Continued bullish reaction to positive news is bullish.

- 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.

- 401k investors and financial planners are providing automatic buying of equities and debt helping the rally, for now.

- 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, for now.

Bearish Case

- Here is what I wrote in my April Market Outlook:

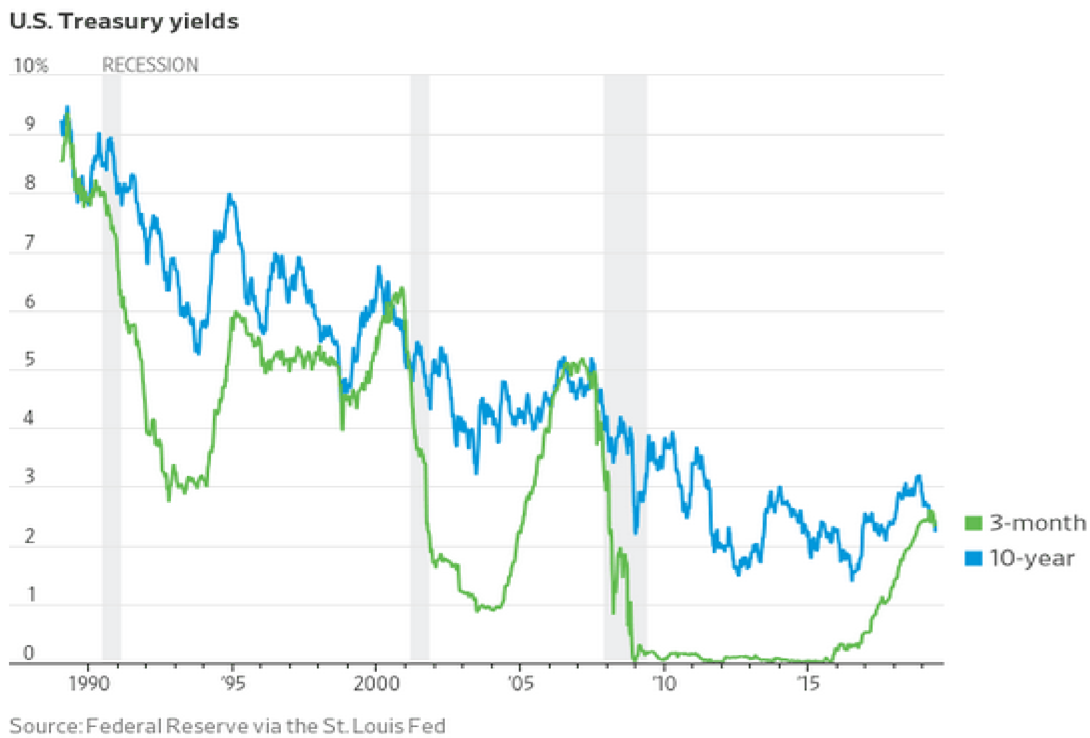
"The current rally is basically based on no more rate hikes, a China deal will be made, the second half of the year economic and earnings growth will be better… Here is the other side of the bullish view: if the economy does strengthen in the second half, then rising interest rates are back on the table; what happens if a 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."

Since there is no trade deal, it would be hard for economic and earnings growth to be better in the second half of the year.

- Like most analysts and investors, we thought a trade deal would happen by now. I thought the President would compromise and not get everything he and his negotiating team wanted. The President and his team are playing hard ball. A trade deal with China will take much more time and this will cause uncertainty. The uncertainty that tariffs will have on restricting trade will be a drag on the global economy and markets. I will write more about the trade war with China next month in my 2nd Quarter Economic Outlook.

  NAFTA II has not been approved by Congress and it was signed over six months ago. If a deal with China is made, it probably wouldn't be approved by Congress well into 2020.

  The yield curve has inverted again, and this is making investors nervous:



  As the chart shows going back 30 years, when we had a yield curve inversion, the economy went into a recession, shaded areas. I don't think this is a good indicator, the credit spread is better. I will write more about both in my Economic Outlook next month.

- The markets are expensive. At the beginning of the year the P/E was almost 15, they are close to 18 now. Earnings are expected to grow about 3% to 4%, but the market is up about 11%. The rise of the markets and the high P/E are not justified in light of the trade war with China and the potential for slower U.S. and global growth and rising geopolitical risks. 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, Yemen, 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 to October.

- Earnings estimates have been falling

- Oil prices are up about 30% from last December's low

- Economists are stating that the stimulus from tax cuts is waning.

- 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.

- 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 (wars, oil supply disruptions, weather related disasters….)

- 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

Market earnings estimates for 2019, 2020 keep falling. I thought the forecast declines would accelerate since the escalation of the U.S. China trade war. As mentioned above, some analysts believe the impact of the trade war on our economy will not be that bad. I think these analysts are underestimating the impact it will have on the global economy that will eventually impact us. Also the trade wars could impact U.S. consumer, business and eventually investor confidence. The escalation of the trade wars is creating much more uncertainty.
Below are my price targets for the markets:

2019 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1614.97	15	**24,224.55**	25,348.00	-4.64%
SPX	167	16	**2,672.00**	2,802.00	-4.87%
2020 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1807.24	15	**27,108.60**	25,348.00	6.49%
SPX	184	16	**2,944.00**	2,802.00	4.82%

Source: Barron's, Thomson Reuters.

Using a moderate multiple, the markets are currently overvalued. If earnings estimates hold up for 2020, the markets have some upside next year. Keeping an eye on earnings forecasts is a key to determining the markets value and direction. Again, for most of the year earnings estimates have been falling.

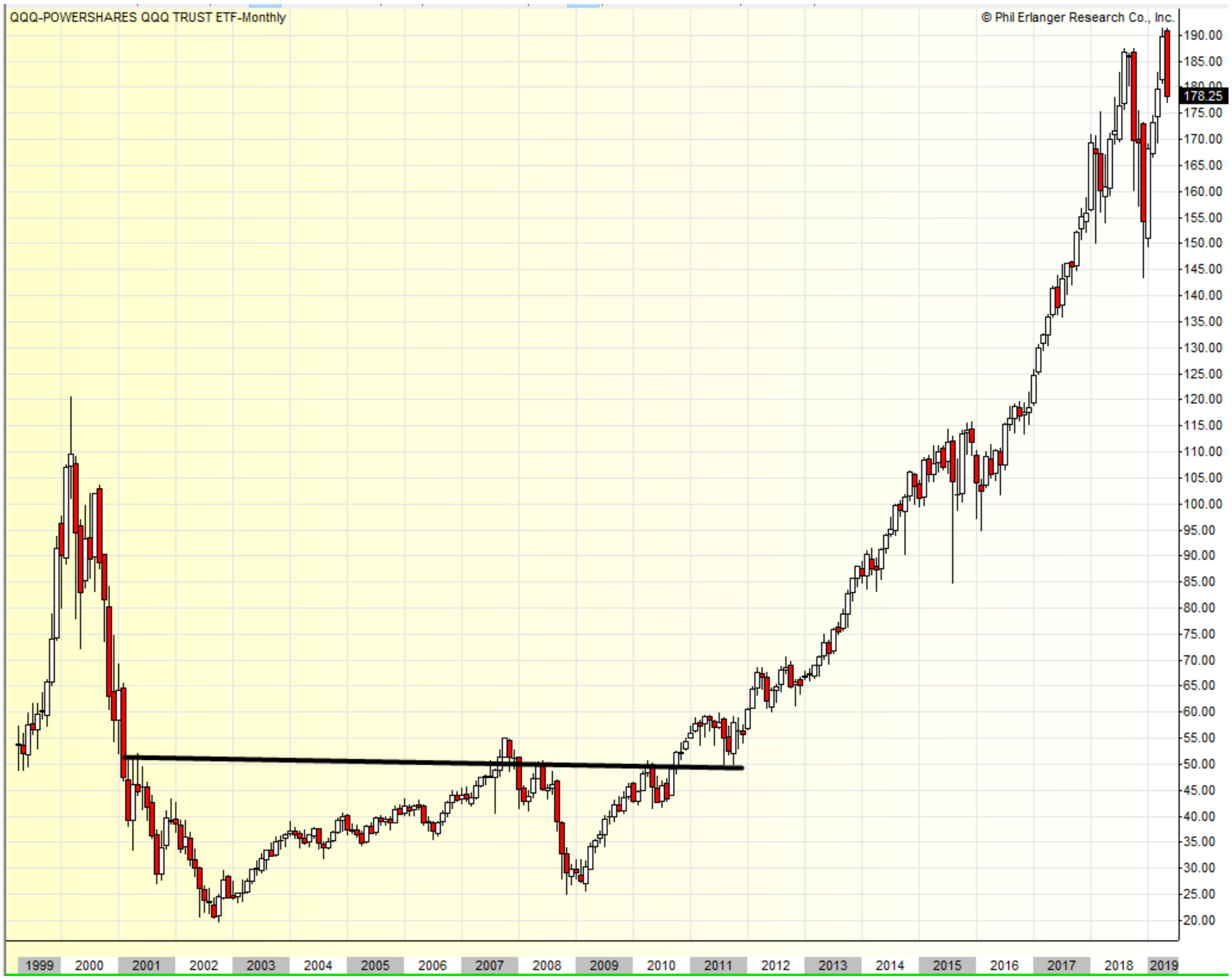
Because of the uncertainty of tariffs and trade wars, we are late in the market cycle and rising geopolitical risks, the markets P/E of over 17 should be adjusted downward.

Price and Technical Analysis

When I was developing this outlook including the charts below, they do not reflect the deterioration of the markets. Prices have been moving lower the last few days. The markets are providing red flags that were in the last stages of this bull market. Most indexes markets are building major reversal topping patterns.

The charts below start with the strongest. The rest of the indexes/charts show that most indexes don't reflect the stronger charts of the S & P, NASDAQ 100 (QQQ), and the SDY (S & P High Yield Dividend Aristocrats ETF).

Below is a chart for the QQQs, one of the strongest index/ETFs:



Source: erlangerchartroom.com

Let's review the QQQ chart:

- The QQQs are popular because the ETF is heavily weighted to the best price performing technology companies.

- The QQQs went parabolic in late 1999, and 2000. It went into a severe bear market and bottomed at around 20 in 2002.

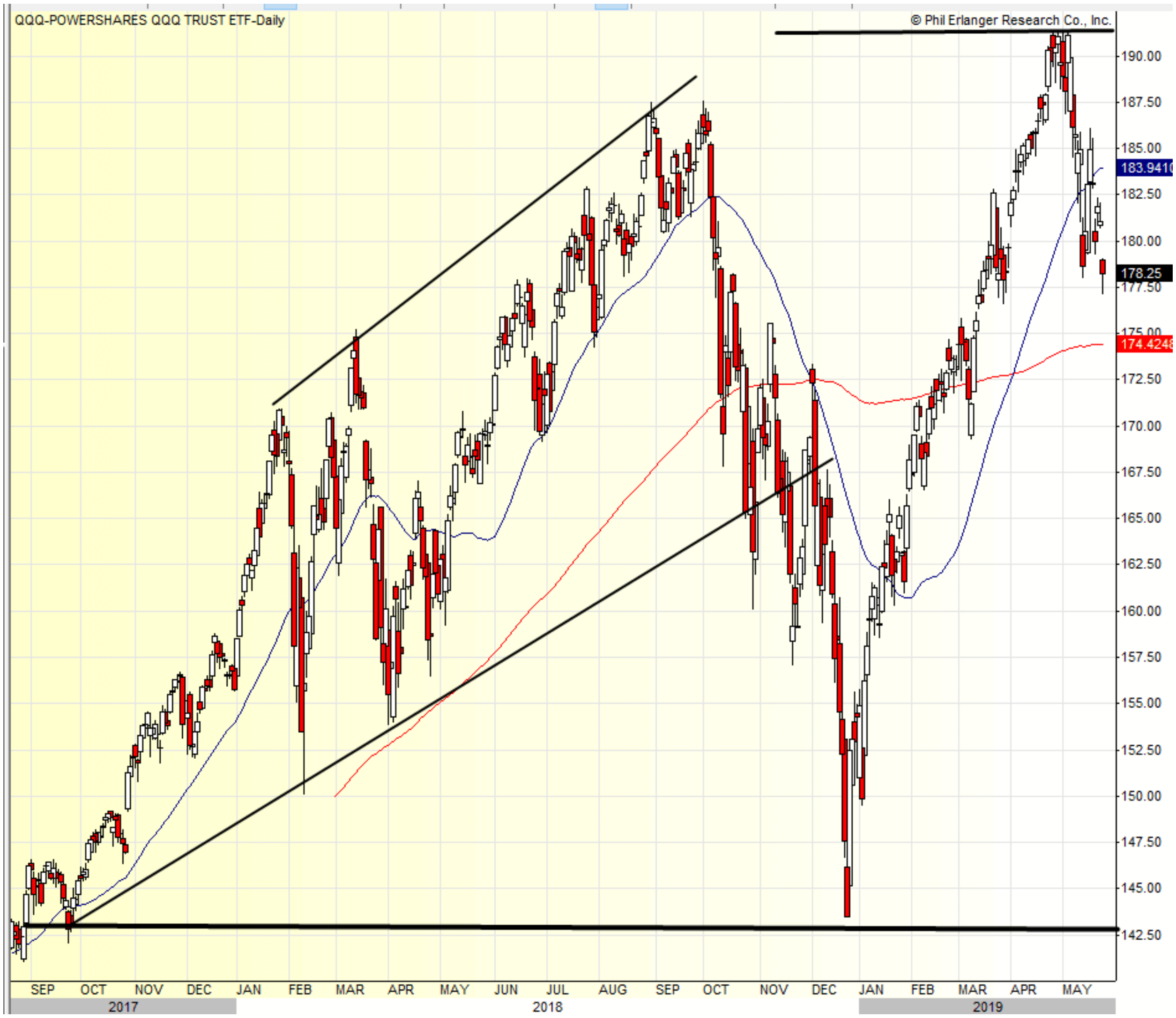
- The market based for around 10 years and finally broke out of its basing patter in 2012.

- From the bottom test in 2009 at about 25, the bull market is about 10 years old and rallied to over 190, or up over 600%.

- The QQQs did make a new high this month, May.

- The QQQs also went parabolic several times during this bull market cycle, a sign of speculation.

Here is a recent chart of the QQQs:



Source: erlangerchartroom.com

What is important about this chart is it shows that like many charts the QQQs have entered the last phase of a bull market as it has developed a major reversal topping pattern:

A bull market is characterized by a rising tops and bottoms trendlines, the upward parallel lines. The bullish trend was broken last year, around October.

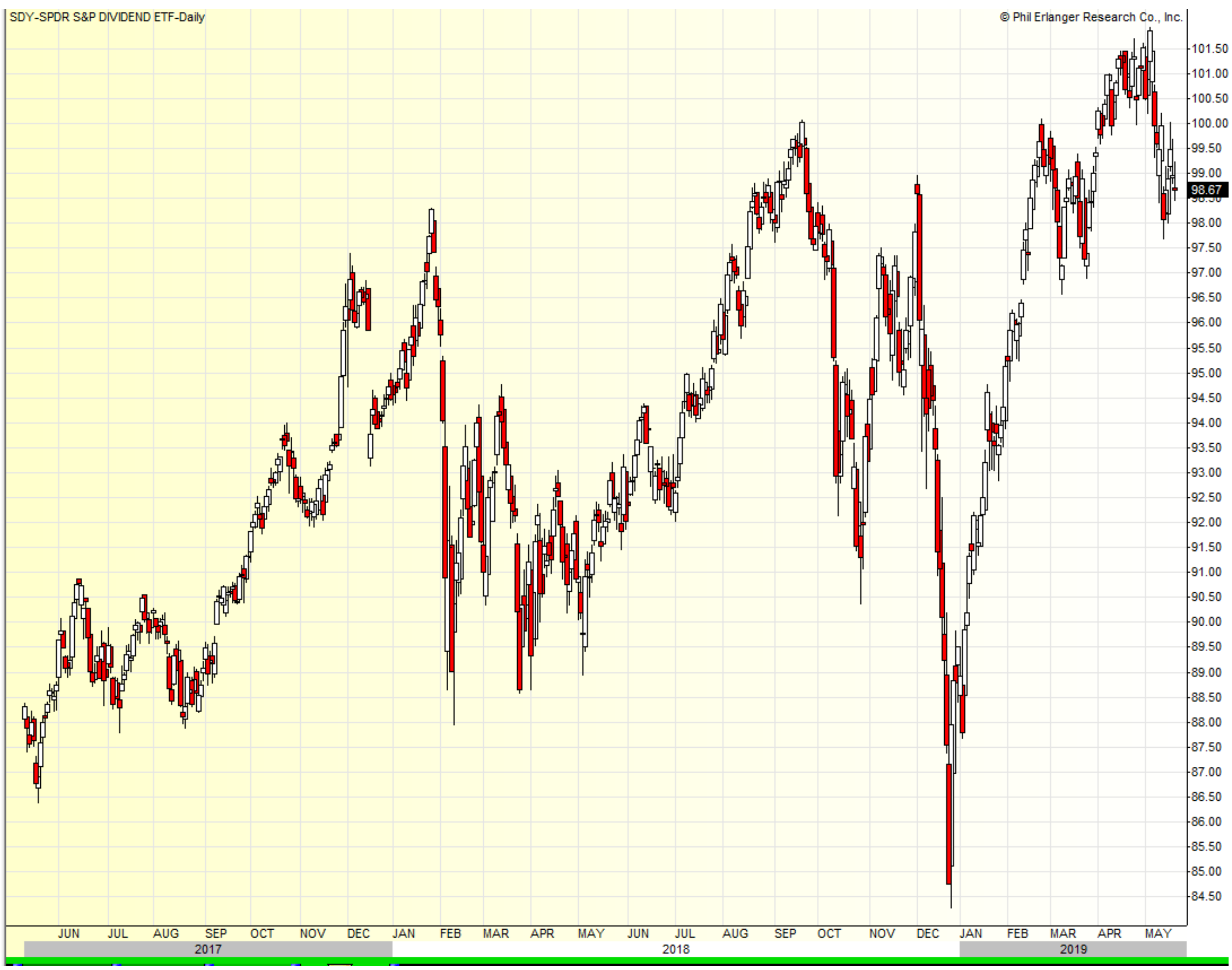
A major reversal pattern takes at least six months to build. This chart is going on about 1 ½ years.

The major support level is about 142 and resistance is around 190.

The QQQs are around 176. If prices fall below the 200-day moving average the red trendline, it would cause a major sell signal (notice what happened last September when prices fell below the 200-day moving average). The 200-day moving average is around 174, close to the current price of 176.

Dividend paying stocks have been a strength in the market for much of this bull market cycle. As us baby boomers retire (or semi-retire) in this low interest rate environment, we are starting to invest in dividend paying stocks because: the dividends can grow, if they fall they can attract investors as the yield increases, and they tend to be safer. I've been investing in dividend paying stocks for my clients and myself since 2008. They've done extremely well.

Below is a chart of the S & P dividend ETF (symbol SDY):

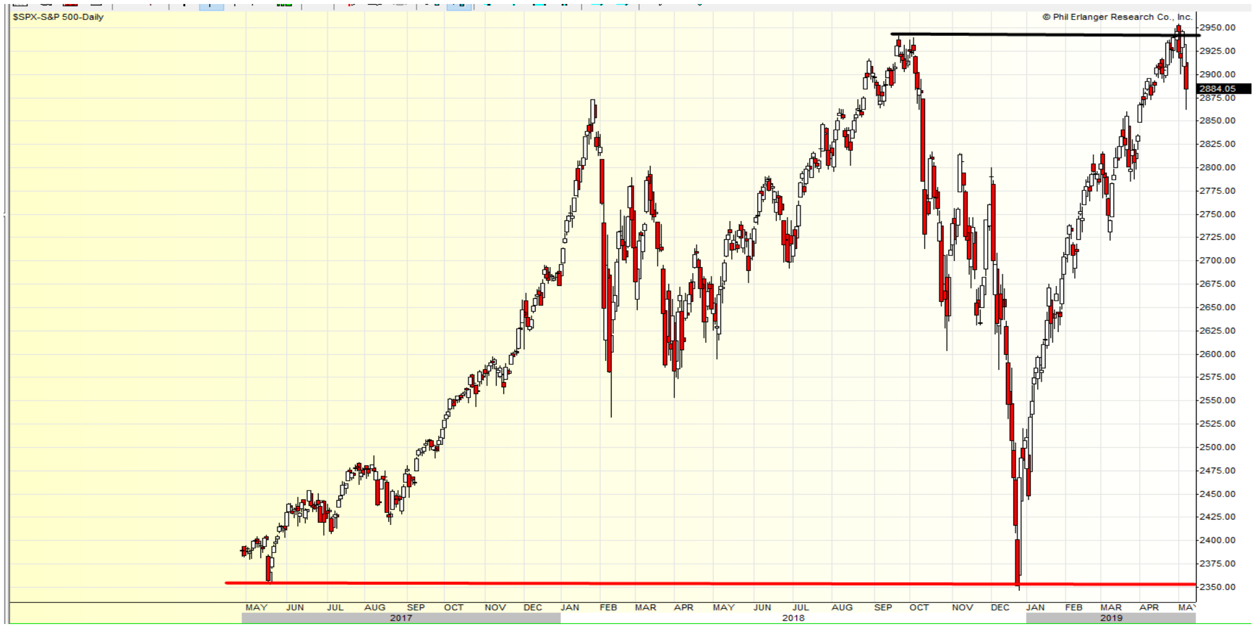


Source: erlangerchartroom.com

Even though prices recently made a new high, it is still making a major topping pattern because it is no longer making higher highs and higher lows. The pullbacks made last January through March and December proves this point.

You will see that all the charts below are building major topping reversal patterns: they stopped having rising tops and bottom trendlines, the patterns are close to two years in the making, there is a defined support and resistance lines, and price action is sideways.

The S & P index and ETF barely made a new high.



Source: erlangerchartroom.com

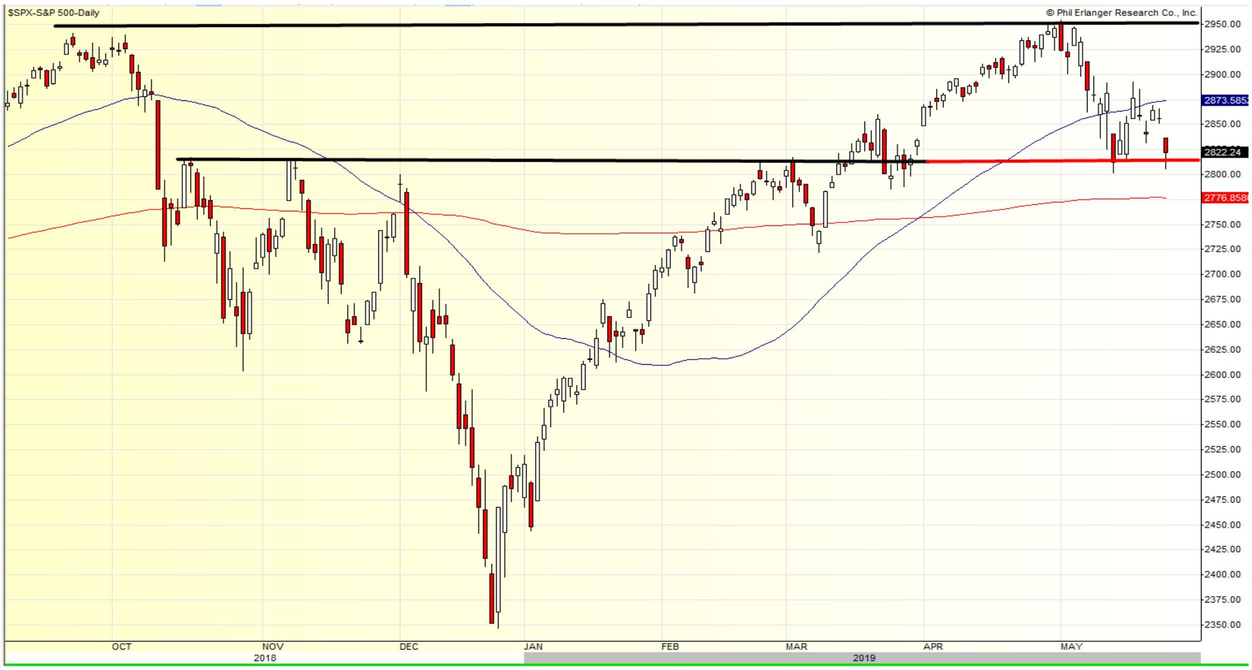
Let’s review the chart:

The S & P has been building a major reversal top for about 2 years.

Support is around 2350 and resistance is around 2950.

A new high was made at the end of last month, but the move was not strong enough to break out.

Here is another chart of the S & P 500 that is important:



Source: erlangerchartroom.com

Here is what is important about this chart.

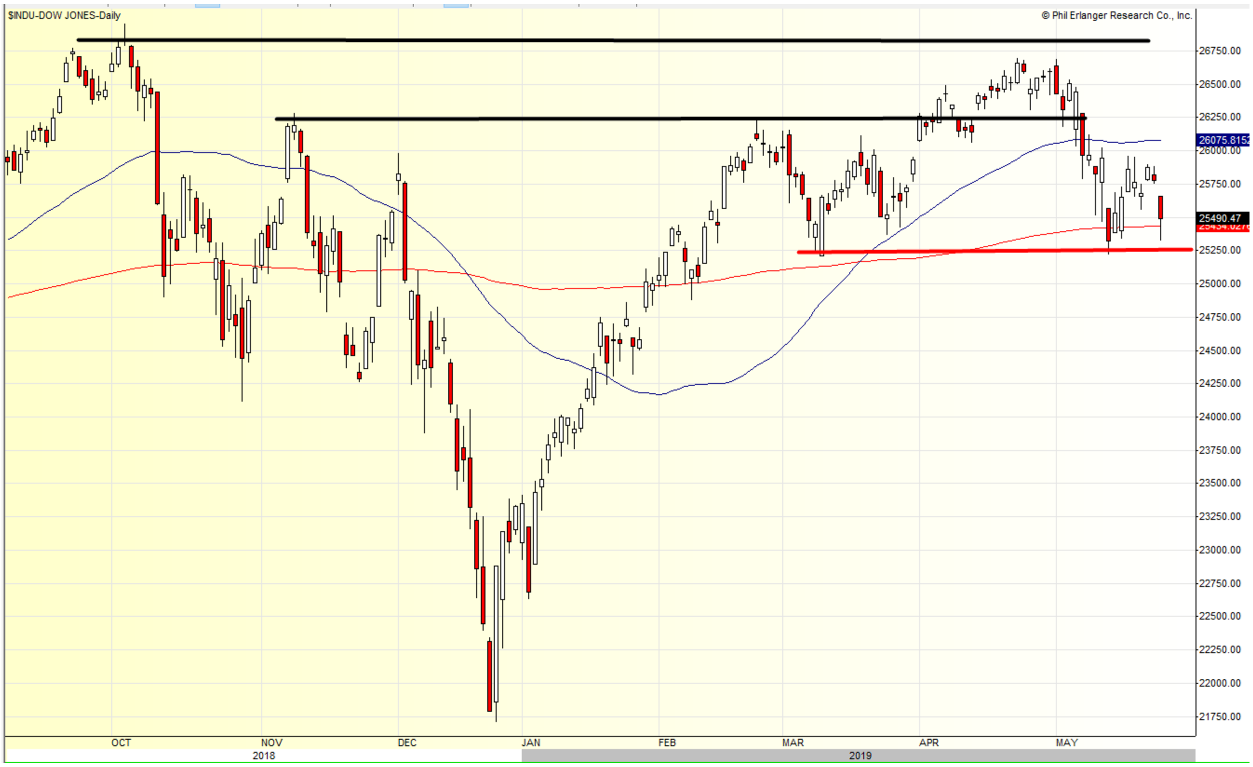
Again, prices did make a new high, but the rally was not sustained. The market became overvalued and there were not enough catalysts to move the market higher.

The 50-day moving average, dark trendline, was breached and created a medium term sell signal.

The S & P had major resistance at the 2820 area. Prices finally busted through and made a new high toward the end of March, but prices retreated. Once resistance is broken, 2820, it becomes support. Breaking the 2820 support level will create another sell signal. At the time of the above chart, prices were testing support but had not breached. While I was writing this Outlook, prices did breach support, 2820, and caused another sell signal.

The next support level/sell signal is the 200-day moving average. As I'm writing the 200-day moving average is around 2775 and prices have touched the 200-day moving average but closed at 2782. If prices break 2775, it would create a long-term sell signal. Last year when prices broke the 200-day moving average it tried 3 times to break above, but the third time the markets had a dramatic fall. This could happen this year too.

The Dow 30 tried to make a new high but failed:



Source: erlangerchartroom.com

Last year the market made a new high of 26951. This year prices rallied to 26241 and did not reach or make a new high.

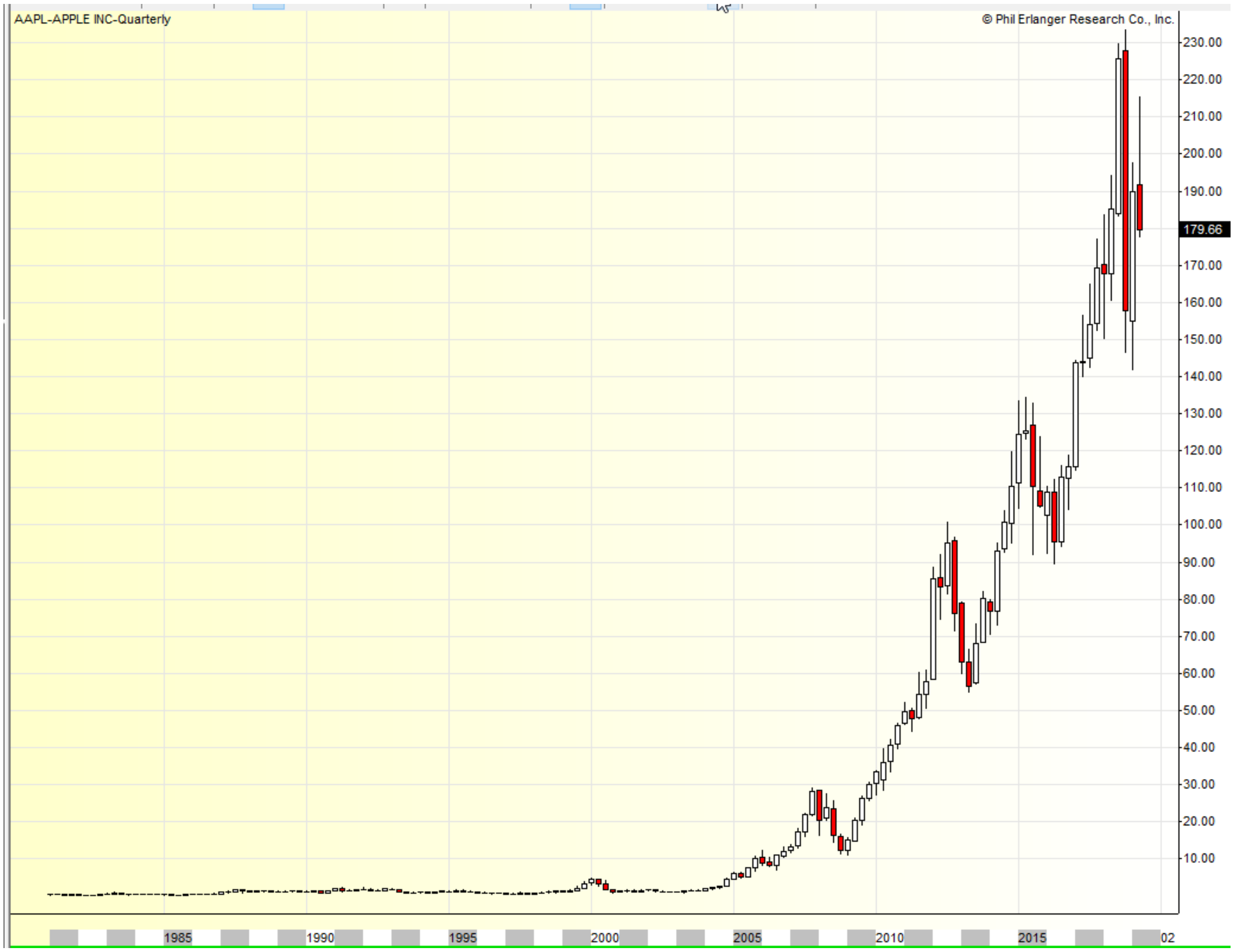
Prices are testing support of 25250 and the 200-day moving average (breaching 200-day would be a long-term sell signal) at around 25340. As of today prices breached both and are at 25161.

Dow Theory, part of technical analysis, states that the transportation index must confirm the trend of the Dow 30. When it does not confirm, then the trend of the Dow 30 is suspect. Here is a chart for the Dow Transportation index..

Source: erlangerchartroom.com

The rally that started last December and ended in April did not get close to reaching the previous high. The Dow Transportation index does not confirm the more bullish chart of the Dow 30. The transportation index has established a major topping reversal pattern.

Apple and FAANG (Facebook, Amazon, Apple, Netflex, Google) have been a market leaders for much of this decade. Below is a long-term chart for Apple:



Source: erlangerchartroom.com

Apple's IPO was in the early 1980s and was dead money for about two decades.

Apple introduced the iPod in 2001 and we can see a small blip in prices.

The first iPhone was introduced in 2007 and Apple stock took off.

Here is a current chart of Apple:

Source: erlangerchartroom.com

Apple stock has been a leader for much of this bullish market cycle. Apple is also making a major topping reversal pattern. The pattern is bearish.

All FAANG stocks are making major topping reversal patterns, but they do not look as bad as Apple. Losing important leadership in the markets is bearish.

Summary and Conclusion

- As anticipated, headline news would whipsaw the markets. At the start of the year the markets tended to focus on bullish news. The markets now are reacting to both bullish and bearish headline news. Headline news will probably continue to move the markets. With no China deal, there could be more bearish headline news.

- The bull's case that a China deal will be made, and economic and earnings growth will get better in the second half is falling apart.

- The Trump administration is playing hard ball with China. A trade deal will take more time to close and a Democratic Congress will have to approve. This will continue uncertainty in the global economy and markets and will be a drag on both.

- Earnings growth for the markets are expected to be about 3% to 4% but the market is up over 10%. The appreciation for the markets is mostly due to P/E expansion. The P/E will probably contract..

- Market and stocks charts are raising red flags. Most stocks and indexes have developed major topping reversal patterns. A sign that we are in the last stages of this bull market cycle.

- Many investors and analysts are concerned about the yield curve inversion.

- As I have been saying for some time, caution is suggested, especially if you’re close or in retirement.

- I will write more about the yield curve, credit spreads and the trade war with China next month in my Quarterly Economic Outlook.