2019 September Market Outlook

The market has been stuck in a trading range for about 2 years. Lately, the market got a boost due to an announcement that there will be a meeting in October between China and the U.S. to negotiate a trade agreement

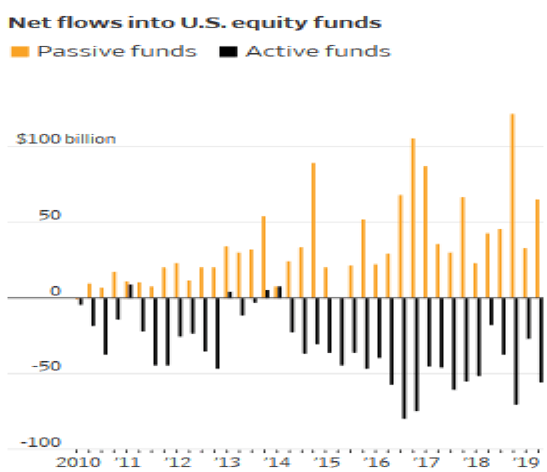
Although an agreement, no matter how bad, may lift the uncertainty many businesses and investors have, I believe it will give the market a boost but may not provide the boost the U.S. and global economy needs. China, Europe, Japan had been slowing before the trade war and a trade deal may not be a sustainable stimulus for the global economy.

Bullish Case

One thing I've noticed the last few years is that this market has several market dynamics that have been bullish for the market versus traditional fundamentals (growth, earnings, inflation, interest rates, energy prices…). I will write a Special Report analyzing these major changes. I do list some of them below.

- **Financial Planners**

For decades, stock brokers helped the individual investor. Today financial planners are replacing stock brokers. Brokers had their clients invest in individual stocks, bonds or mutual funds. Financial planners use asset allocation and rebalancing strategies and invest mostly in ETFs. Below is a chart that shows the change:



Note: Estimates for U.S. open-end and exchange-traded funds in respective categories
Source: Morningstar

I will explain how this change has given the markets a bullish bias in my Special Report I mentioned above. Briefly, financial planners rarely have their clients sell, but rebalance their portfolio and new money gets invested. Mutual funds are managed and the managers can act to reduce risk and raise cash.

Financial planners rarely talk about valuations.

Today the markets are up about 20%, but earnings are only up about 2% year to date. Why, financial planners are more focused on diversification and not fundamentals and valuations.

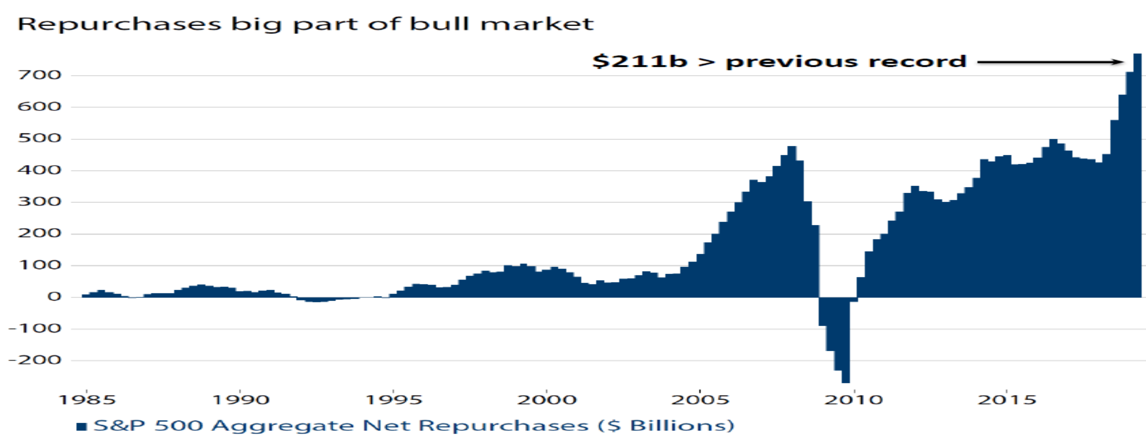
Most retirees need safety, income, liquidity and not asset allocation and rebalancing. If you have a financial planner and would like a free review of the risks, liquidity, fees and income your portfolio has, contact me at danhassey@yahoo.com.

- **401k and Target Funds.**

The 401k was developed to shift the risk and burden of retirement from the employer to the employee. Employers, the investment industry and regulators noticed that many employees did not contribute to their retirement or if they did they kept their money in money funds or company stock. Bad investment strategies. The investment industry came up with target funds to help 401k investors. You pick the year you anticipate to retire (the target). If you are young, the target fund will invest more aggressively and becomes more conservative as time passes. If you're close to retirement, the target fund will be conservative.

- **Buy Backs**

When a company buys its own stock it's called a stock buyback. 2018 and 2019 buybacks exploded mostly due to the big tax cuts corporations got with the new tax law that was passed at the end of 2017.



Source: S & P Capital IQ Compustat

As the chart shows, repurchases are a main reason for this bull market. Some analysts believe that buy backs will taper off as the benefits of the tax cuts and a slower growth of revenue and profits reduce cash flow to buy back stock. This could reduce one of the supports for this market.

It's a bad idea for companies to buyback stocks this late in the cycle at high valuations.

- The consumer is the bright spot in the economy.
- Most Americans, especially investors, analysts and business people are naturally optimistic. This translates, fortunately, to economic expansions and bull markets that last much longer than recessions and bear markets.

- FOMO, fear of missing out. Investors tend to buy on any pullbacks, selling – FOMO.

- TINA, there is no alternative. Some analysts and strategists are telling clients, investors to invest in U.S. stocks because TINA. Bonds and money markets yields are too low, emerging and international stocks have too much risk.

Money markets, T-bills, CDs pay around 2% and provide liquidity, safety, flexibility and are a consideration this late in the cycle, especially when taking into account the many risks listed in the Bearish Case section below.

- Inflation is behaving, for now

- The Fed is starting to cut rates, twice this year.

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

- Some analysts and economists believe the increased U.S., China tariffs will have a lesser impact than most people believe. This view point is being accepted by many investors.

- The market continues to react favorably to good news versus bad news. High frequency traders, speculators, trend followers, momentum players jump on trends, bullish or bearish. More about this in the Technical/Price Analysis section below.

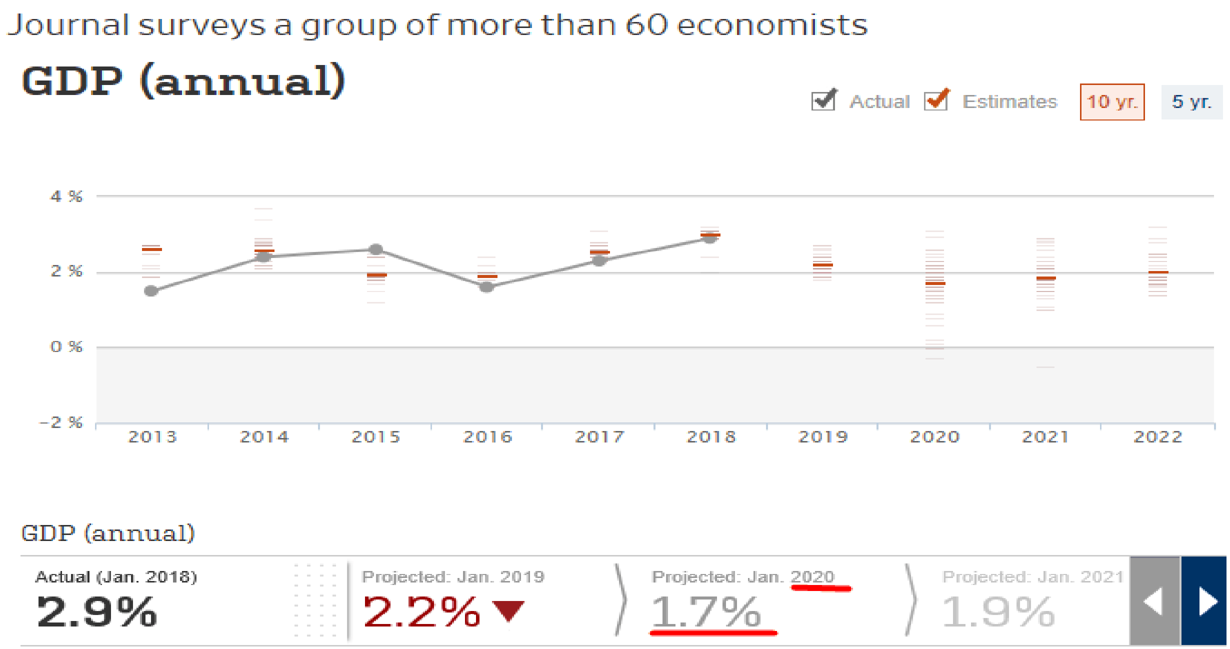
- Many investors believe there will be a China trade deal.

Bearish Case

- The markets are overvalued. Earnings are expected to be flat to negative for 2019, yet the markets are up about 20%. Financial planners and 401k investors don't pay much attention to valuations.

Many economies around the world were slowing but tariffs and trade wars are causing the global economy to slow even more. Tariffs, trade wars and a slowing global economy is causing a slowdown in the U.S. economy A year ago, GDP grew at 4.1%, the second quarter of this year it slowed to 2%.

Below is the latest Wall Street Journal (WSJ) consensus forecast for GDP growth for 2020:



Source: WSJ

Growth is expected to slow to around 1.7% next year.

- The market is no longer in a bullish trend. Below is what a bull market looks like:

Source:www.erlangerchartroom.com

Let's review this bullish chart.

1. What is happening on rallies most of the time?
Rallies are pushing higher creating a pattern of rising tops (higher highs).

2. What is happening on pullbacks most of the time?
Pullbacks are higher than prior pullbacks creating rising bottoms (higher lows).

3. Rising tops and rising bottoms also create a bullish upward channel, the two solid black trendlines.

Fundamentally and normally, when we see this type of chart earnings are growing and news is positive. Earnings increase the wealth of companies, and investors bid up the stock to reflect the increase in the wealth created. During pullbacks selling is met with buying. This prevents the asset from pulling back to the previous low. The influx of buying takes prices to new highs. Investors and traders are "buying the dips."

In the long-run prices will gravitate toward fair value. However, in the short-run market psychology and momentum tend to have a greater influence over prices.

Stocks are influenced by inflation, interest rates and mostly by earnings (a company's ability to make money for shareholders). Let's see how earnings influence stock prices. Again, the pattern normally is anticipation, consolidation and adjustment

1. Earnings are announced the first few weeks after a quarter has ended. Notice a few weeks before the stock moves up. This is the anticipation phase, the first move up from mid-January to mid-February.

2. The consolidation phase lasts from February to the middle of March.

4. You will see the same process happen every quarter in a bullish stock/market.

This what the market looks like now:

Source: www.erlangerchartroom.com

Let’s review the Dow 30 (the S & P trend is a bit more bullish).

- The Dow 30 is no longer is making higher highs and higher lows.

- Most indexes like the Dow 30, have been going sideways for about two years. Notice it is not following the quarterly anticipation, consolidation pattern of a bull market.

- The above pattern is called a major topping pattern, specifically it looks like it is forming a rounding top. These type of patterns are normally the last phase of a bull market.

If we get a trade deal the markets could break out to new highs and start a new higher trading range. If there is not a new trade deal with China then the market could roll over into a bear market.

- Leadership keeps changing (risk off to risk on, technology to dividend payers, and other bond proxies.)

- Most analysts, and economists agree we are in the late stages of this economic and market cycle. Many analysts bring up the topic of recession. Most believe we won’t have one, but the fact that recessions are constantly brought up means it is a concern. Also most analysts and economists would agree that predicting recessions is extremely difficult. Can anyone really predict the future? This is why I invest when stocks are undervalued not fairly or overvalued, in other words, buy low, sell or hedge when prices are high, overvalued.

- 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 and Britain will probably go into a recession if Britain leaves without a better deal from the EU.

- Earnings estimates have been falling, see valuations section below

- Lowering rates now would be risky:

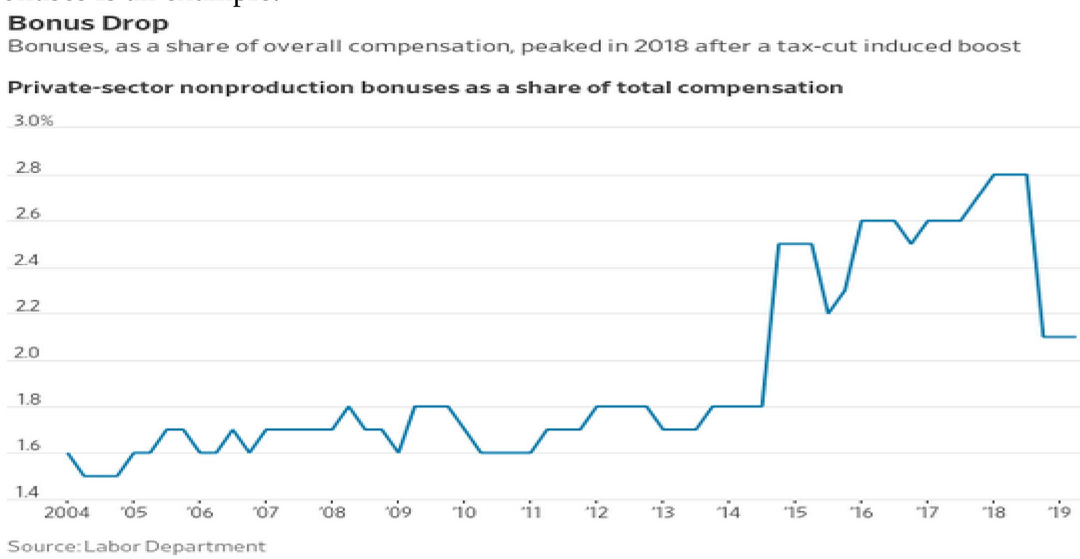
Several prominent economists have talked about the problem when we do go into a recession we won’t have the normal tools of lowering rates and government spending and cutting taxes. Rates are too low and we’ve already cut taxes and increased spending so monetary and fiscal efforts may not be available/effective. This could cause the next recession to last longer. Lowering rates now is risky and unwise.

Another risk is if a China Trade deal is made, a deal could stimulate the economy and with lower rates the risk of an overheating economy and inflation could be a problem

Investors and traders have got to ask themselves, will several ¼ point cuts keep the expansion going and if a ½ point is taken, what happens when we go into a recession? Rates will be too low to be an effective economic stimulus. Japan and Europe have had ultra-low rates and both economies have been anemic.

Another way to look at lowering rates now is like taking antibiotics before you get sick where it won't be helpful. We need antibiotics when we're sick. We need to lower interest rates to stimulate the economy when we are in recession or when we have a financial crisis.

- Economists are stating that the stimulus from tax cuts is waning. Declining employee bonuses is an example:



We can see that the tax cuts caused some companies to issue one time bonuses (versus pay raises). This year the bonuses issued have been reduced.

- The dollar remains strong and is hurting earnings and trade.

- Growing deficits will probably get worse and may be headwinds going forward. They are currently over $1 trillion.

- Crowded index funds may cause problems for investors if they all try to head for the exits as the economy and earnings slow. Too much money is going into index ETFs, passive funds. I will write more about this in my Special Report on how the markets and investing have changed. Again, financial planners and 401ks are the main drivers of this trend.

I will write more about crowded ETF index funds. I will also suggest reducing exposure to the most crowded ETF indexes.

- 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.

  The President reinstated sanctions against Iran. They are suspected of disrupting oil supplies from the Middle East including the downing of a U.S. drone, and the bombing of major energy infrastructures in Saudi Arabia. The latest bombing caused oil prices to spike.

  We should not be surprised if Iran retaliates more.

- Consumer, business, confidence are starting to decline

- Black or grey swans (wars, oil supply disruptions, weather related disasters, cyber-attacks….)

Valuations, Market Price Targets

As anticipated, earnings estimates have been adjusted downward all year. Here is my current market price targets:

2019 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1506.83	15	**22,602.45**	27,110.00	-19.94%
SPX	167	16	**2,672.00**	3,005.70	-12.49%
2020 FORECAST					
	EARNINGS ESTIMATES	P/E	FORECAST	CURRENT PX	PTNTL %
DJIA	1766.03	15	**26,490.45**	27,192.00	-2.65%
SPX	184	16	**2,944.00**	3,025.86	-2.78%

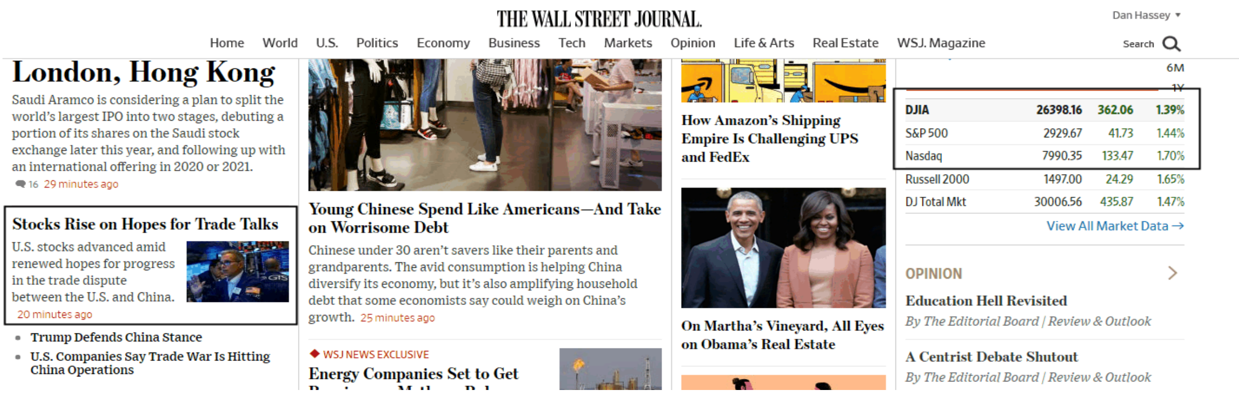
Source: Barron’s, Thomson Reuters, Dan Hassey data base

I use a moderate P/E that I believe is warranted this late in the cycle and with the many risks listed in the previus bearish section. The markets are very overvalued this year and slightly overvalued for 2020.

Because the markets have been overvalued, the technicals, price action could be more helpful in analyzing the markets.

Psychology of the Markets

The word to describe this year’s psychology of the markets is HOPE.


THE WALL STREET JOURNAL.

Dan Hassey

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Saudi Aramco is considering a plan to split the world's largest IPO into two stages, debuting a portion of its shares on the Saudi stock exchange later this year, and following up with an international offering in 2020 or 2021.

16 29 minutes ago

Stocks Rise on Hopes for Trade Talks

U.S. stocks advanced amid renewed hopes for progress in the trade dispute between the U.S. and China.

20 minutes ago

- Trump Defends China Stance
- U.S. Companies Say Trade War Is Hitting China Operations

Young Chinese Spend Like Americans—And Take on Worrisome Debt

Chinese under 30 aren't savers like their parents and grandparents. The avid consumption is helping China diversify its economy, but it's also amplifying household debt that some economists say could weigh on China's growth. 25 minutes ago

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6M

DJIA	26398.16	362.06	1.39%
S&P 500	2929.67	41.73	1.44%
Nasdaq	7990.35	133.47	1.70%
Russell 2000	1497.00	24.29	1.65%
DJ Total Mkt	30006.56	435.87	1.47%

View All Market Data →

OPINION

Education Hell Revisited

By The Editorial Board | Review & Outlook

A Centrist Debate Shutout

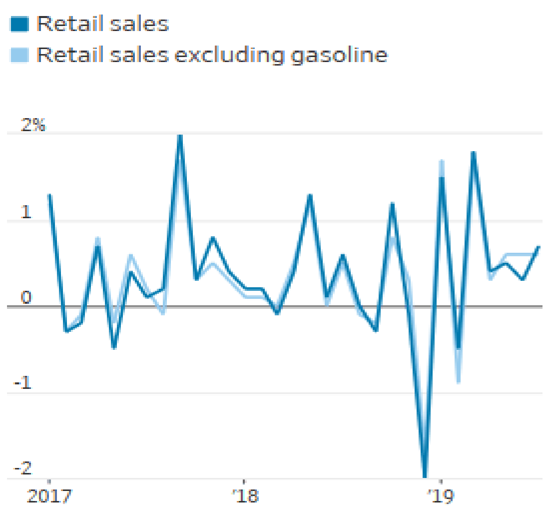
By The Editorial Board | Review & Outlook

Source: WSJ

The above image is from the Wall Street Journal. The headline reads: "Stocks Rise on Hopes for Trade Talks". The opposite side of the headline is the markets' reaction regarding the headline, the Dow 30 was up 362 points.

Lower interest rates and a better second half of 2019, the consumer remains strong are also hopes of the market. Hope is not an investment strategy.

The consumer is the bright spot in the economy. Retail sales is a metric that reflects the consumer:



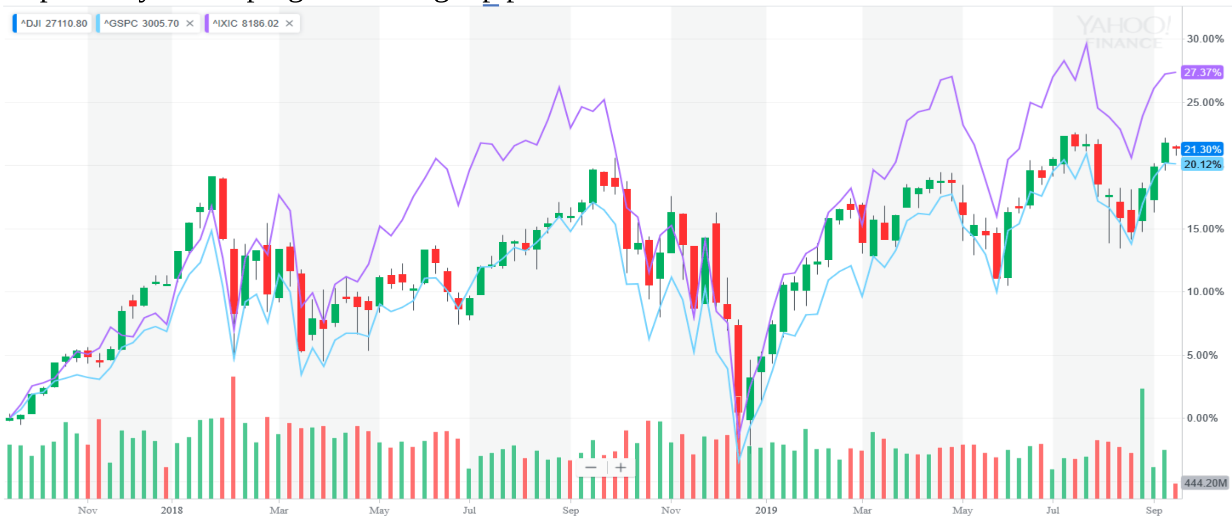
Note: Data are seasonally adjusted
Source: Commerce Department via St. Louis Fed

Retail sales took a hit due to market volatility and the government shutdown. Investors are hoping retail sales stay positive.

Again, normally what drives the market are fundamentals: profits, growth, inflation, interest rates, employment….

Price and Technical Analysis

Below is a chart that shows that the three major indexes have been going sideways. From a technical, price analysis the pattern is called a major reversal pattern, and they are probably developing a rounding top pattern:



Source: Yahoo Finance

The Dow 30, S & P 500 and the NASDAQ are the markets shown in the above chart. They have been going sideways for about 2 years and are about the same place they were about 1 ½ years ago.

The NASDAQ is the strongest because it has faster growth technology stocks.

The S & P and Dow 30 have almost mirrored each other.

Below is a chart hat shows that this is a trading market and not a buy and hold market:

Source: www.erlangerchartroom.com

The chart above is of Kimberly Clark, KMB. I often write about trend followers, momentum players, hedge funds and high frequency jump on trends, exaggerating trends.

The stock is popular when risk is off because it's a consumer staple and at support the dividend is close to 4%. When risk in on traders sell stocks like KMB and buy higher growth, riskier stocks. As mentioned above there is constant rotation in the markets. This is not a good market for a buy and hold strategy.

KMB has been going sideways for about 4 years. Support is about $100 to $102 and resistance is about $137 to $140. The stock is about where it was about 4 years ago. Traders would buy around the $102 area and short sell around $137 making about a 60% return by trading this stock including shorting. This happens about once a year.

This year the stock did fall to $100 and recently reached $142, a 42% return. Below is a look at its growth rate:

Annual EPS Consensus Expectations

	FY '19	FY '20	FY '21
Mean as of 09/12/19	$6.82	$7.21	$7.63
Previous Mean	$6.70	$7.00	$7.40
# of Brokers	17	17	12
Range (low/high)	$6.71/7.03	$6.78/7.61	$7.29/8.04
Stnd. Deviation	$0.07	$0.19	$0.22
Announce Date	01/23		
Year Ago EPS	$6.61 A		

Change Over Previous Year

	'19	'20	'21
Kimberly-clark Corp	3.1%	5.7%	5.8%
Industry	NA	NA	NA
Sector	NA	NA	NA
Market	2.5%	10.8%	10.3%

Source: I/B/E/S Earnings Valuation Report

KMB's growth rate for this year is about 3%, but the stock is up over 30% from its April low. As I've been writing about all year, it is better to look at the technicals price action versus the fundamentals. In my March Outlook, I write about the importance of technical/price analysis in this type of market. Most of the time it is better to focus on the fundamentals. You always need to know the value of what you invested in and what your risk/reward potential is. If you would like to review my March Outlook, email me at danhassey@yahoo.com.

Summary and Conclusion

- There are some market dynamics (financial planners, 401ks, stock buybacks…) in this cycle that is giving the market a bullish bias. I will write a Special Report on how the market has changed. I plan to issue the report in October.

401ks and financial planners are investing heavily in ETF indexes. These indexes are crowded and I will review the most crowded and investors should consider reducing exposure to these ETFs

- Part of the bullish bias this year is hope (a China trade deal, more rate cuts, the consumer, and a better 2nd half and 2020). Not a good investment strategy.

- Risks are rising, the list (slowing global growth, trade wars, growing geopolitical risks) keeps growing and are serious.

- In this market, technical/price analysis is important. Investors should always know the valuation and prospects of the investments one owns.

My Special Report on "Is a Recession on the Horizon" should be out late this month, or very early in October. The key to the outlook will be if a trade deal is made – soon.

Most retirees need safety, income, liquidity and not asset allocation and rebalancing. If you have a financial planner and would like a free review of the risks, liquidity, fees and income your portfolio has, contact me at danhassey@yahoo.com.