2019 November Market Update

The markets have a bullish bias despite being overvalued and the many risks that face the global economy and markets. To quote Barron's recently, a weekly investment publication "The major stock market indexes rose to records again this past week against a backdrop of domestic political fights and global geopolitical tensions. It almost appears as if the equity market resides in a separate universe." Because the markets are overvalued and divorced from the fundamentals and realities of the economy, I've been focused on the technicals, price action of the markets.

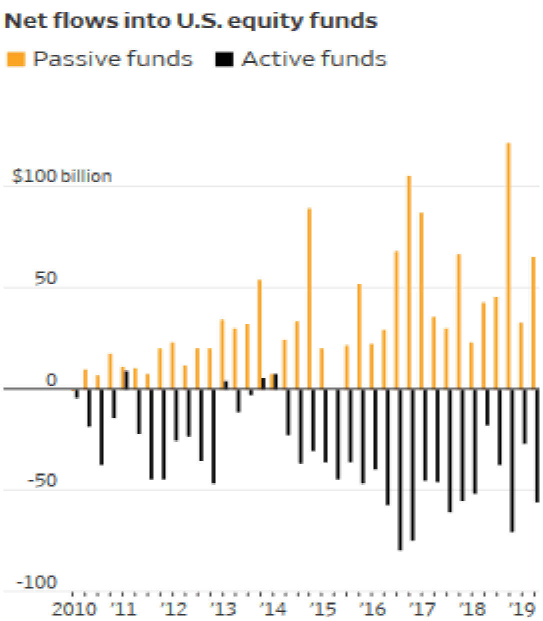
Below, I provide my normal bullish and bearish case, price targets/valuations, price/technical analysis, the psychology of the markets and my conclusion and summary.

Bull Case

Bullish bias caused by financial planners and 401Ks

In my 2019 September Market Outlook, I explain why this cycle has a bullish bias. Click here to read the report, or email me for a copy of the original Outlook, danhassey@yahoo.com.

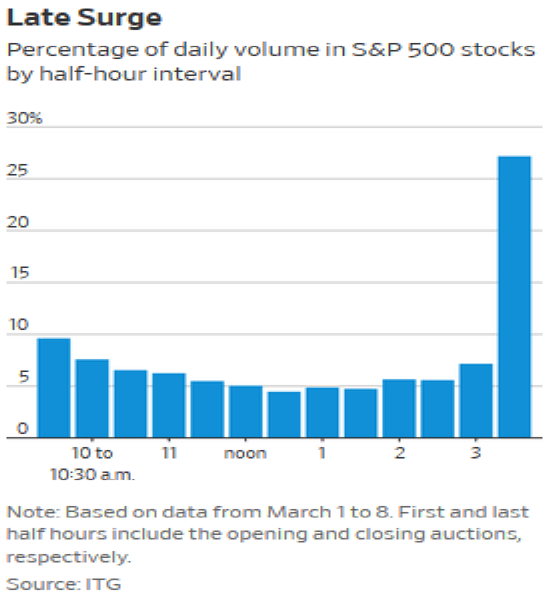
Briefly, financial planners and 401Ks invest in in ETFs as part of their asset allocation strategies. The chart below show how money has come out of managed mutual funds and into passive ETFs:



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

More money has been going into ETFs/passive funds and money is leaving active mutual funds.

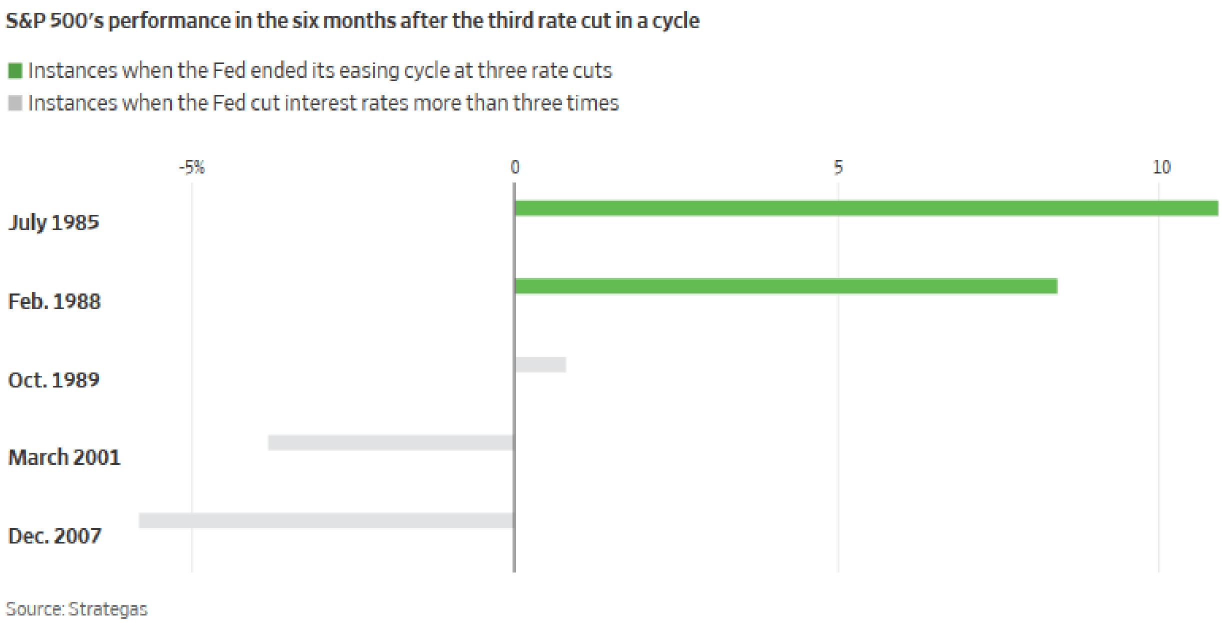
Individual investors can buy/sell an ETF anytime when the markets are open. But a lot of the orders for ETFs and the stocks in the ETFs are bought at the end of the day.
We can see buying spike at the end of the day due to passive investing by financial planners and 401K investors.



Reasons for current bullish run

- The yield curve inverted earlier in the year and has normally been a predictor of recessions. The yield curve has snapped back to normal and the fear of a recession has been reduced.

- A belief that the global economic slowdown is bottoming, central banks around the world including the U.S. are lowering interest rates and the lower rates stimulation should start working going forward. Here is a chart that some investors and analysts point to as one of the reasons why they have turned bullish:



See bearish section on why investors should not be bullish regarding this chart.

- As the markets and certain stocks move higher, analysts have been raising their price targets so they don't look out of step with the markets and investors. Most of the target increases by these analysts are done by increasing P/Es.

- Inflation is low and is a reason why rates could stay low. See bearish section for problems with rates being too low.

- Earnings better than expected. Earnings estimates for 2020 are forecasted to grow about 5 to 8%. See valuation section for more details

- A China deal is expected. See more about this in bearish section

- New highs normally means that resistance levels/sellers of the market have been taken out and continued new highs would be normal. See technical/price analysis section.

- According to a recent Wall Street Journal article, there has been strong foreign buying of U.S. equities

- FOMO (fear of missing out) of a rally or potential upside. TINA (there is no alternatives), in past mature, overvalued or bear markets investors would be able to move to 5% or higher money markets. Today money markets only pay about 1.5% and for most of this cycle they paid below 1%. Investors are keeping their money is equities.

- The consumer is the largest component of our economy and they’re holding up – for now.

- There is about $3.4 trillion of investor money in money markets. Some analysts believe FOMO will cause some of this money to go back into equities.

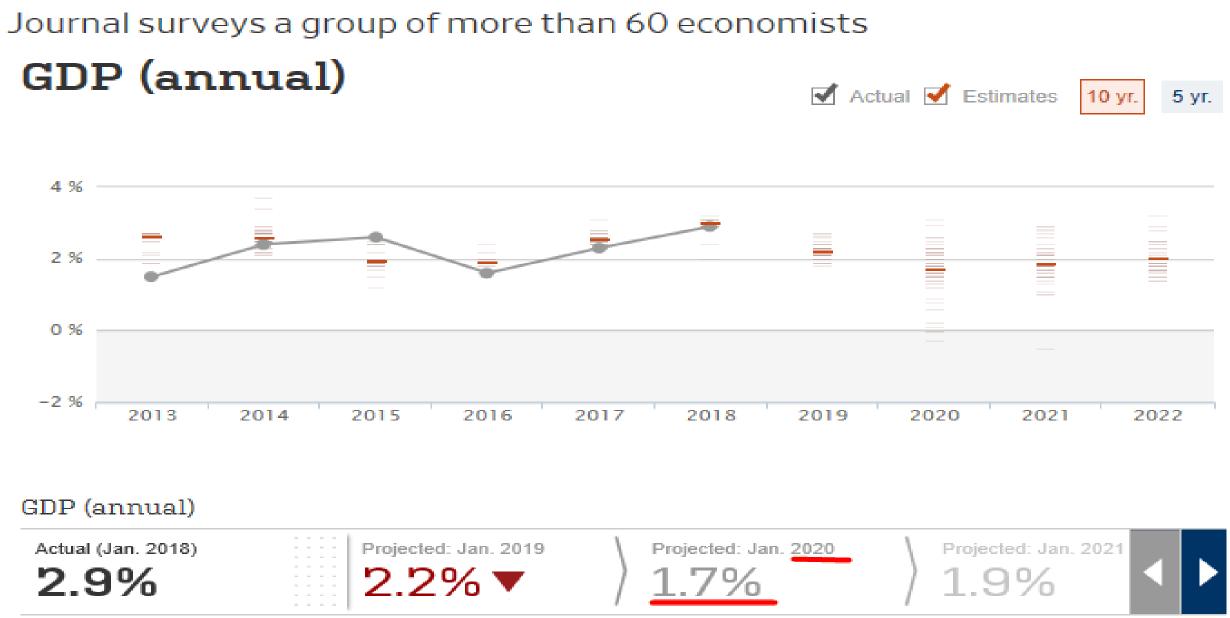
  If these investors are like me, I won’t buy at these expensive levels this late in the market and economic cycle with rising risks.

Bearish Case

- The markets are overvalued. See valuations section below

- There seems to be an earnings recession this year. See valuations section below

- The global and U.S. economy are slowing. The chart below shows the slowdown in our GDP:



Source: WSJ

GDP grew 2.9% in 2018. GDP growth for 2019 is expected to grow a low 2%, and next year below 2%.

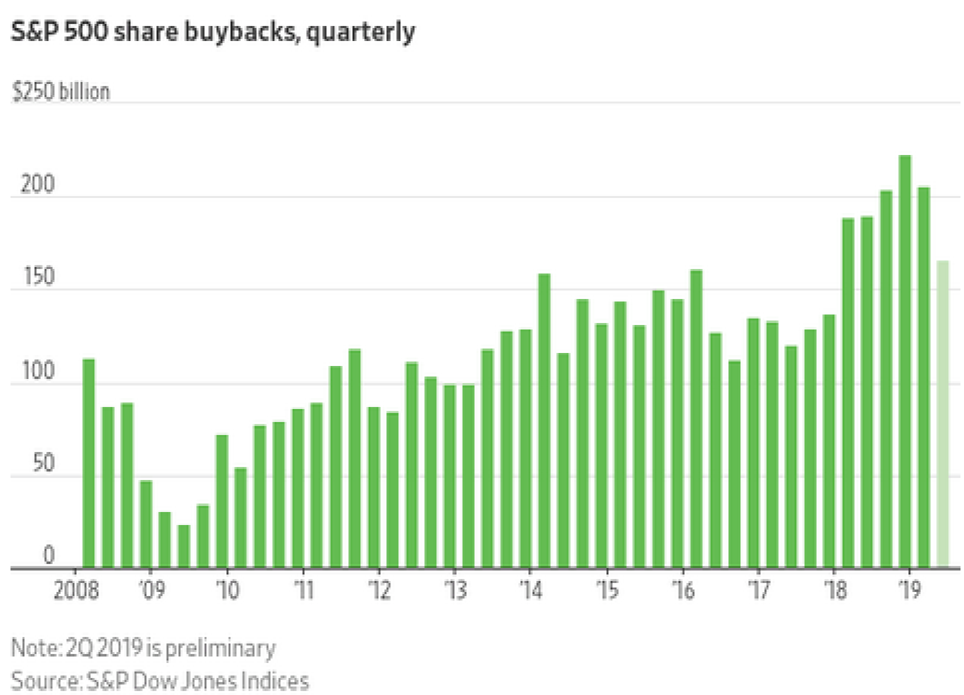
- A major China trade deal is unlikely before the elections. The markets seems to ignore bad news about China trade, but rally strongly on any good news regarding trade.

Again, the market is expecting a China trade deal. Trade talks started in February of 2017 and is going on 3 years. Investors keep getting disappointed, but still have unwarranted hope. A short-term agreement may be made, but that's more than priced in the market. The Chinese have stated that they can't agree to some of the demands of the U.S. and they have stated that a long-term agreement is unlikely. It's also been reported that they can probably strike a better deal after the elections.

- We have sanctions and unresolved issues with: North Korea, Iran, Venezuela, Russia. Bexit, Syria and Islamists extremists remain risks.

- Research shows that if there is a major change in economic policies with an election of a new administration, there is normally a major reaction by the markets. When President Trump was elected there was a major rally due to his pro-business policies. If a democratic president is elected, we may see a reversal in the markets because most democrat candidates are more concerned about labor and the consumer.

- One of the variables that has helped this bull market, especially last year is corporate buybacks of their stock. We are seeing buybacks slow the last couple of quarters.



Fewer buybacks could slow the progress of the current bull market.

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

- The topic of recession keeps coming up in the financial media.

- Lowering rates now is 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 may not be available/effective. This could cause the next recession to last longer. Lowering rates now is risky and unwise.

Also, many economists and some analysts complained that interest rates were too low this cycle as they don't pay enough to protect a dollar against inflation. The low rates reflect that our economy and markets are addicted to low rates and that is not economically healthy.

In the bullish section, there is a chart showing market performance of the market after 3 rate reductions. Some analysts are pointing to this chart saying that the market could be up 6 months from now. Here are the problems with this thinking.

- This economy is more like the 2000s (3 rate decreases and the markets were down) versus the 1980s (3 rate decreases and the markets were up).

- The 1980s had baby boomers entering the job market, starting families, and buying their first homes. In the 2000s, many young people can't afford the down payment and have too much debt, especially school loans.

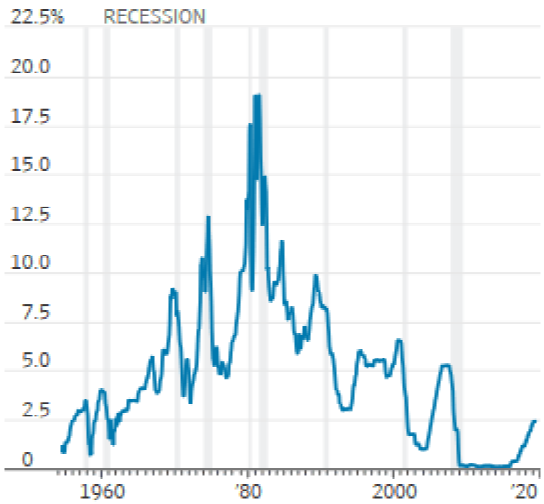
- Baby boomers are starting to retire and are no longer in their peak earnings and spending years.

- Our economy and markets are much larger now and those type of gains, especially after a year like 2019 have a low probability.

- Rates dropped dramatically from a peak of around 18% in 1980 and by the end of the decade it dropped to about 8%. The fall in interest rates and oil prices were conducive to some of the markets best gains in market history.

Gimme Back My Bullets

Effective federal-funds rate

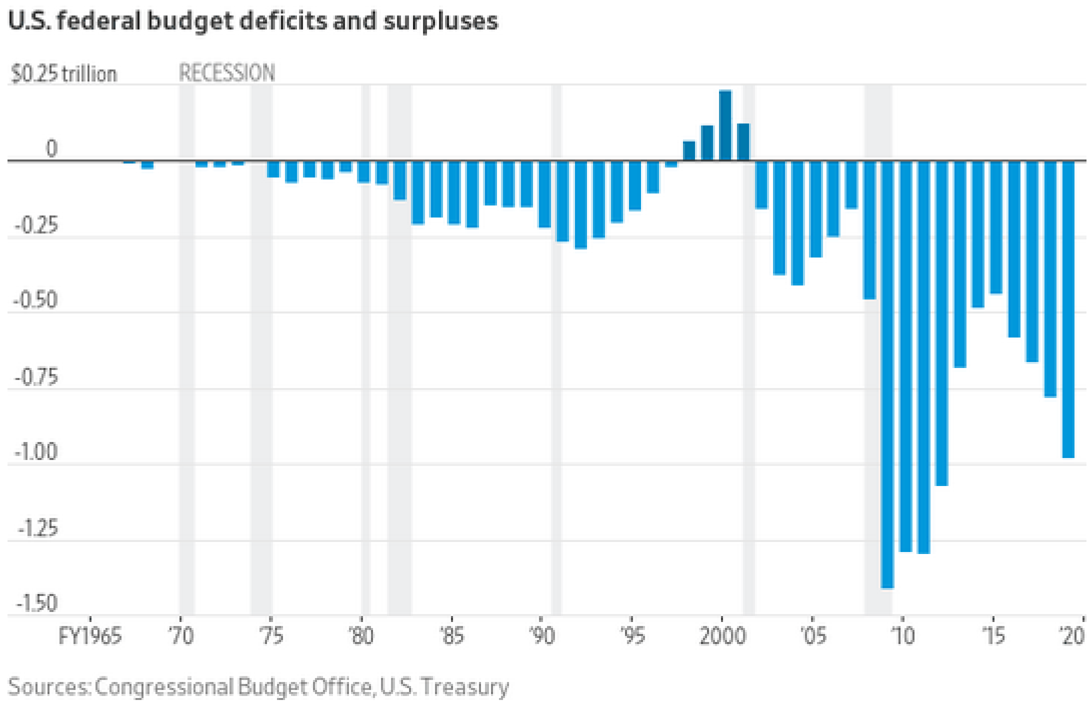


Source: Federal Reserve

In 2019, rates dropped from around 2.25% to 1.5%. The comparison by analysts of rates dropping in the 1980s versus today is not appropriate.

- Expecting the markets to continue perform like the chart in the bullish section is unrealistic this late in the market and economic cycle.

- The increasing deficit would make it difficult to use tax cuts or government spending to stimulate the economy if we have a recession or a financial crisis:



Tax cuts and baby boomers retiring and collecting Social Security and Medicare benefits has caused the deficits to explode again. If we go into a recession and have less tax revenue but higher expenses, our growing deficits can get even worse.

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

- President has too many balls in the air (China, North Korea, Russia, Iran, Venezuela, U.S. economy, immigration, healthcare, gun control, climate change's impact, reducing the budget deficits and growing national debt, impeachment inquiry…) and the mishandling of these important issues is possible.

The markets believe that the Senate will not impeach the President. This is probably true, but it is distracting him from a China trade deal and the other important issues listed above. He has not come up with economic policies to win the 2020 elections. The inquiry and potential Senate hearings could take a toll on the President's poll numbers and reelection bid.

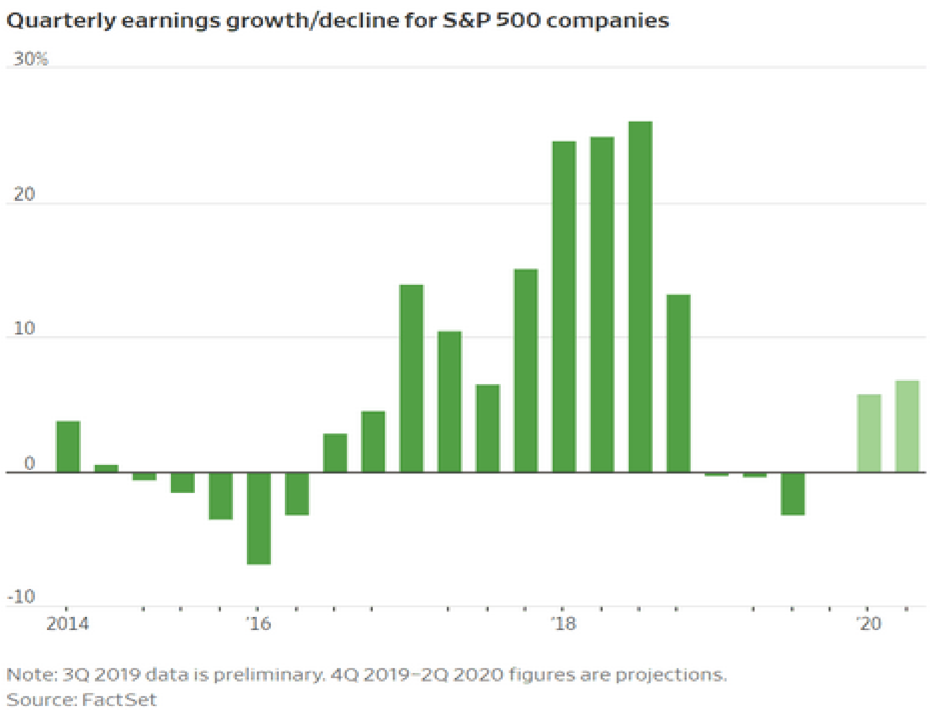
- Consumer, business, confidence are starting to decline

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

Valuations

On 10/29/18, the Dow 30 earnings forecast was 1720.33. Earnings estimates have been falling consistently for most of this year. Currently the 2019 earnings estimates have come down about 15% to 1465.29. Despite the dramatic lower revised estimates by about 15% the Dow 30 is up around 20%. Dow 30 earnings estimates for 2020 were 1823.80 in April, and have been revised downward by about 4% to 1704. It is highly probable that 2020 earnings estimates will continue to fall.

Below is chart that shows the reported earnings for the S & P for the last few years:



There was an earnings recession between 2014 and 2016, and there is an earnings recession now. Earnings are expected to grow about 5 to 8% next year (analysts tend to be too optimistic and they normally lower estimates as the year progresses).

Below is table that show some of valuation metrics for the markets. I underline the forward P/E estimates for the markets.

Dow Jones Industrial Average

28036.22 ▲31.33, or 0.11%

High, low, open and close for each trading day of the past three months.

	Last	Year ago
Trailing P/E ratio	20.87	20.84
P/E estimate *	18.60	16.02
Dividend yield	2.20	2.23
All-time high	28036.22, 11/18/19	

S&P 500 Index

3122.03 ▲1.57, or 0.05%

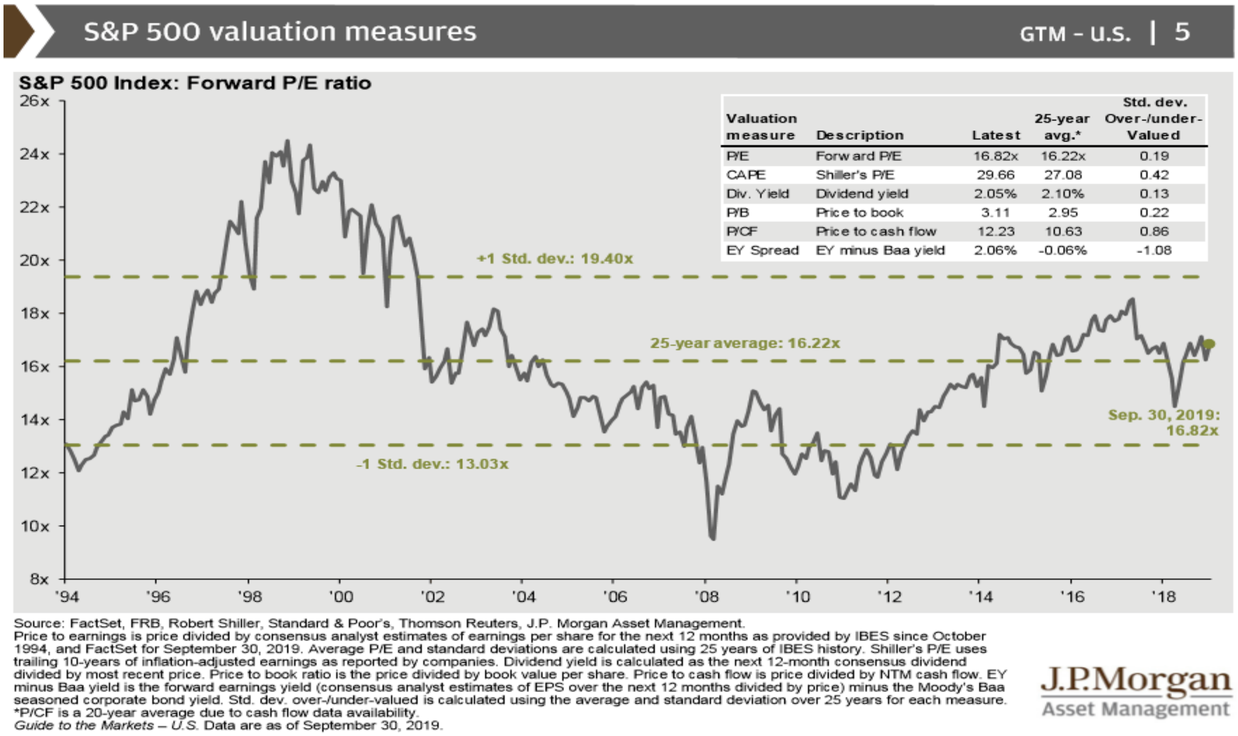
High, low, open and close for each trading day of the past three months.

	Last	Year ago
Trailing P/E ratio *	24.23	21.64
P/E estimate *	18.91	16.70
Dividend yield *	1.87	1.94
All-time high	3122.03, 11/18/19	

Source: WSJ

The forward P/E estimates are higher this year versus last year. Both P/Es are close to 19. Most of the markets gains are due to rising P/E multiples and not better economic and corporate performance.

Below is a chart that shows the historical range of P/Es.



Source: JP Morgan Asset Management

The average historical P/E for the markets for the last 25 years is about 16.22.

Here are my price forecasts for the markets:

2019 FORECAST					
	EARNINGS ESTIMATES	**P/E**	**FORECAST**	**CURRENT PX**	**PTNTL %**
DJIA	1465.29	15	**21,979.35**	27,110.00	-23.34%
SPX	162.86	16	**2,605.76**	3,005.70	-15.35%
2020 FORECAST					
	EARNINGS ESTIMATES	**P/E**	**FORECAST**	**CURRENT PX**	**PTNTL %**
DJIA	1704	15	**25,560.00**	27,712.44	-8.42%
SPX	175.49	16	**2,807.84**	3,095.87	-10.26%

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

I use a 15 multiple for the Dow 30 because it is growing slower versus other indexes. I use a 16 multiple for the S&P and is slightly lower than the historical average because of increased risk, a slower economy and we are in the late stages of this economic and market cycle. You don't want to pay top dollar (a high 18 P/E) this late in the cycle.

Using moderate multiples, the markets are overvalued.

Market Psychology

At the start of the year the markets were optimistic about a China trade deal, strong earnings, and the Fed would lower rates. The only hope that was realized was lower rates.

Investors, the markets continue to hope for a China trade deal and better earnings. Despite investors being wrong, the markets are up. When the fundamentals aren't a factor, the technicals/price analysis become more important. Below is my technical/price analysis.

Technical/Price Analysis.

The markets are doing better than I thought this year. I knew that the economic and geopolitical news would be mixed and the markets would reflect the mixed news and would continue to trade in its two year trading range and that the lows would be tested. The markets continue to trade in its trading range, but prices have not tested its lows of last year. Below is a chart of the market basically moving in a trading range going back more than two years.

Source: wwwerlangerchartroom.com

Let's review this chart:

- Prices peaked in January 2018, and prices have struggled to stay above that level for almost two years.

- Notice the difference between 2018 and 2019. 2018 saw the Fed raised rates four time in 2018 causing the market to correct. In late 2018, the market broke through several support levels like the 200 day moving average and the 2550 level.

In 2019, the Fed lowered rates three times helping the markets, but the yield curve inverted and the inverted yield curve is considered a good predictor of recessions so the market fell in May. The yield curve snapped back to normal and the fear of a recession receded. After the May correction and the normalizing of the yield curve and recession fears receded, selling was met with buying giving the market a bullish bias.

- A true breakout occurs if prices can stay above the previous resistance level/the previous high.

- There have been many breakouts over the decades and traders have developed filters they use to determine how strong a breakout is.

1. The breakout should rise at least 3 to 5%.

2. Volume must be significant. Volume represents money, and lots of volume, money is needed to sustain the breakout. On the above chart, volume can be seen on the bottom pane.

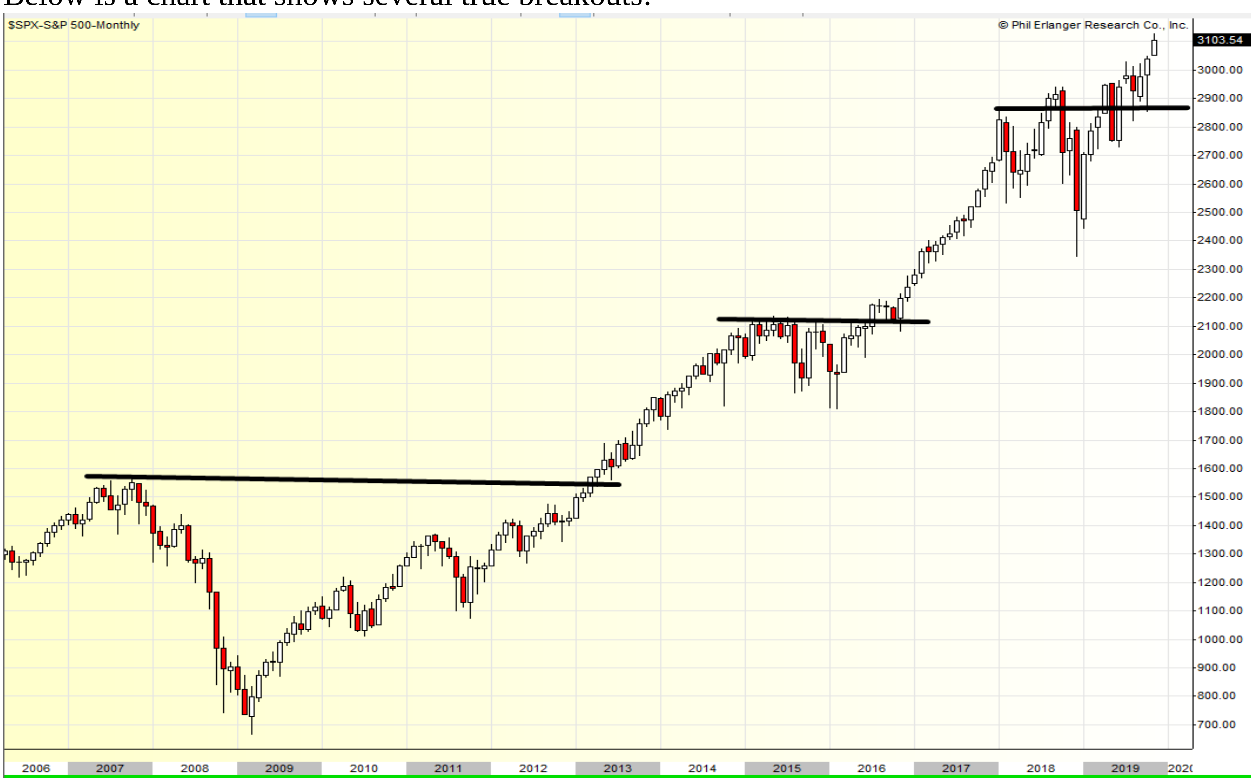
3. The breakout should last at least 2 days.

4. On those 2 days of the breakout, prices should close at the high of the day.

- The first 3 breakouts failed as they did not meet the above filters, and it was not surprising to see prices fall below the 2018 January high.

- The current breakout has been the strongest breakout over the last two years. The market has advanced more than 3%, but the other filters were not met (weak volume, the breakout has not been consistent with a few days closing at the lows of the day). The last few days volume has picked up, but it's on the downside. The current breakout is suspect.

Below is a chart that shows several true breakouts:



Source: wwwerlangerchartroom.com

Let's review the breakouts in the above chart:

- The first breakout was in 2013, and prices stayed above the resistance line/the previous historic high. We also had a rising tops and bottoms trendlines, a true bull market. The recession was over in the summer of 2009, and the market bottomed in March of 2009. The market doubled from the bottom of 2009 to the breakout in 2013.

For a breakout, bull market to be sustained there also needs to be a catalyst. In 2013, the Great Recession was over and a recovery had taken hold, and earnings were strong. The new economic and market cycle began in 2009.

- The next breakout in late 2016 (after the election of President Trump) was followed by a strong advance that ended in January 2018. Prices stayed above the resistance level at the 2100 level.

The catalyst was a new President that was pro-business and the prospects of tax cuts, deregulation, infrastructure investing, and better trade agreements especially with Mexico, Canada, and China.

- As mentioned above, the current breakout is suspect. The only catalysts that could sustain the breakout is a China trade agreement and the re-election of the President if he can come up with economic programs that can sustain this economic cycle last another few years. This has never happened in our modern economic history, an economic cycle lasting more than 10 years.

- The markets remain in their trading ranges. The pattern that has developed is called a major reversal pattern and is the last stage of a bull market.

Summary and Conclusion

- The markets have a bullish bias due to: hopes of a China trade deal, better earnings in 2020, the President won't be impeached and he will be reelected, the global economy is bottoming and global central bank lowering of interest rates should help stimulate the global economy.

  Also helping: breaking above historic highs, and the buying of passive funds by financial planners and 401Ks, and a relatively healthy consumer.

- There are few economic/market indicators that support the above hopes.

- The current breakout could be sustained if there is a major China deal to eliminate the global economic uncertainty, and the reelection of President Trump and a credible economic agenda. Using monetary policy would be difficult because rates are too low. Fiscal policies would be difficult because of our huge deficits and national debt.

- The markets are overvalued with a backdrop of a slowing global and U.S. economy, rising risks, and several unsettled U.S. disputes with our trading partners and global foes.

The markets have not priced in no long-term China trade deal, slower growth and earnings, many geopolitical risks, the potential of a new pro consumer and labor President.

- The markets remain in a major reversal pattern, the last stage of a bull market.

- There are short-term trading opportunities, but I would not invest in any long-term positions until we go from overvalued to undervalued.

In December I will provide a consensus economic outlook for 2020. In January I will provide my 2020 market outlook with my price targets for the markets.

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.

How to contact Dan Hassey, Registered Investment Advisor: danhassey@yahoo.com
I can review your portfolio gratis. The review would include: 1.Upside potential 2. Risks 3. Costs 4. Make sure your portfolio is meeting your financial needs and goals. I would be willing to spend up to three hours on the free review.

Below is a brief bio. You can also review my LinkedIn profile. https://www.linkedin.com/in/dan-hassey-7a71301/

Dan Hassey's passion for investing started at the UCLA Graduate School of Management where he earned his MBA. After UCLA, Dan started his investment career as a stock broker for Merrill Lynch in their Beverly Hills office. He has also worked for Paine Webber, Fidelity Investments, Charles Schwab, and for famed futures money manager John Henry & Co. Inc.

Dan has also worked as a research analyst covering the markets, and the economy. Dan also recommended, energy and dividend paying stocks. Contact me if you would like a copy of my track record of my stock recommendations.