



# MACRO MUSINGS

February 25, 2019

Rush Zarrabian, CFA  
Portfolio Manager  
Corbett Road

## MARKET RALLIES WHILE THE FED TAKES A PAUSE

### SUMMARY

- **While the risks of a recessionary bear market are rising, they are increasing from a very low probability point.**
- **The Fed's recent comments suggest they've gotten the message from the market and economy. At this point, we do not expect any rate hikes for at least the first half of the year, and maybe not at all for 2019.**
- **The market rally since Christmas has been persistent, with an 18% gain in two months. Although it could be a rally within a bigger decline, certain characteristics of the rally suggest we are not in a bear market.**
- **Geopolitical concerns remain. The US/China trade talks are at the forefront, but now the risk of a messy break up between the United Kingdom and the European Union is on the radar.**

## THE RISK OF AN AGGRESSIVE FED HAS DROPPED

They got the message from the market. The combination of last quarter's market decline and recent weakness in key economic data have pushed the Fed to hold off on more interest rate hikes.

Respected Fed watcher, [Tim Duy](#), suggests that if the economy slows down enough, the next move could be a rate *cut*:

**The Fed is out of the picture through at least the first half of this year as central bankers work to understand the path of economic activity going forward.** Of course, we will all be doing the same. As it currently stands, there is a widespread expectation that growth slows in 2019. The ultimate degree of slowing, however, remains the key question. Enough to keep the Fed from thinking they need to snug up policy a little tighter? Or enough to prompt a rate cut? Still unknown, but with **inflation failing to live up to expectations it does seem that the Fed has a fairly high bar to a rate hike and a low bar to a cut.**

This makes sense. The Fed was likely too aggressive in raising rates last year given the global economic slowdown that was already unfolding. They realized this in January and are now more willing to take a wait-and-see approach.

We believe this change in the Fed's outlook has a lot to do with the market's strength through the beginning of the year.

## BUT IS THIS JUST A BEAR MARKET RALLY?

As of 2/22/2019, the S&P 500 has risen 18% from its low on Christmas Eve, but its current level remains 5% off its all-time high from September.

Whenever stocks rebound after a big drop, you tend to hear pundits with a bearish bias suggest that we are experiencing a "bear market rally." This time has not been any different, and there is the suggestion that the recent move up in stocks is just a pause in the selling or a way to suck investors back in before the next big drop.

While we can't rule anything out, several factors dispute this call and suggest this is more than a temporary rally within a new bear market. These indicators show the rebound could continue in the months ahead.

First, the market is back above its 200-day moving average after a significant drop. This has resolved bullishly in the past, and this has never occurred during a bear market (from bullmarkets.co):

What happens next to the S&P 500 when: S&P closes above its 200 dma, after being more than -14% below its 200 dma over the past 3 months									
	1 week later	2 weeks later	1 month later	2 months later	3 months later	6 months later	9 months later	1 year later	
2/12/2019									
1/3/2012	1.18%	2.43%	3.80%	6.83%	10.67%	7.59%	13.21%	14.83%	
12/29/2011	1.17%	2.06%	3.91%	8.79%	11.52%	7.85%	14.07%	15.79%	
12/23/2011	0.93%	2.11%	4.20%	8.08%	11.63%	4.32%	13.93%	12.07%	
11/8/2011	-1.42%	-6.89%	-3.26%	1.27%	5.96%	6.43%	9.94%	8.15%	
10/27/2011	-1.82%	-3.49%	-7.16%	-2.72%	2.21%	8.82%	7.84%	9.91%	
7/13/2009	5.56%	9.00%	10.35%	15.88%	18.92%	27.29%	32.88%	21.56%	
6/24/2009	2.49%	-2.03%	8.69%	13.83%	17.75%	24.09%	29.39%	19.17%	
6/1/2009	-0.40%	-2.03%	-2.50%	4.65%	9.13%	15.76%	18.61%	13.56%	
1/31/1975	2.14%	5.87%	8.55%	5.88%	15.90%	14.30%	16.02%	31.02%	
1/29/1975	2.19%	3.44%	5.60%	6.96%	13.00%	14.98%	17.15%	27.53%	
9/25/1970	2.81%	2.72%	0.58%	2.35%	9.39%	20.67%	18.30%	18.50%	
1/11/1967	2.78%	2.85%	4.66%	5.94%	6.36%	10.70%	16.02%	15.75%	
11/23/1962	1.17%	2.47%	1.77%	6.84%	6.37%	13.78%	16.61%	13.11%	
Average returns	1.44%	1.42%	3.01%	6.51%	10.68%	13.58%	17.23%	17.00%	
% of cases that are positive	77%	69%	77%	92%	100%	100%	100%	100%	

Second, the market achieved “breakaway momentum”, a metric developed by former Merrill Lynch Market Analyst Walt Deemer. Breakaway momentum compares the number of advancing stocks on the New York Stock Exchange to those that are declining to measure market breadth and momentum. It is a powerful upside move that peaks at the beginning of a market advance. This indicator has never peaked during a bear market (from the Fat Pitch Blog):

Signal Date	Peak A-D Ratio	1 - Day Return	1-Week Return	1 - Month Return	3 - Month Return	6 - Month Return	12 - Month Return
7/14/1949	2.070	-0.20%	0.74%	3.58%	7.98%	15.15%	14.06%
11/20/1950	2.010	-0.25%	1.25%	0.20%	11.04%	7.93%	13.80%
1/25/1954	2.010	0.62%	0.23%	-0.39%	7.13%	16.89%	36.95%
1/24/1958	2.000	-0.29%	-0.02%	-2.54%	2.61%	11.24%	34.26%
7/11/1962	2.370	0.52%	-2.65%	-0.45%	-1.14%	11.07%	20.84%
11/9/1962	2.500	1.38%	2.35%	5.94%	12.96%	19.11%	24.80%
1/18/1967	2.130	0.03%	0.07%	2.41%	6.15%	8.11%	11.39%
12/4/1970	2.120	0.54%	0.89%	1.89%	8.37%	12.85%	8.50%
12/8/1971	1.980	0.04%	1.67%	6.80%	12.23%	12.28%	22.37%
1/8/1975	2.460	1.61%	3.00%	12.16%	14.72%	33.55%	35.04%
1/6/1976	2.530	0.45%	2.18%	8.96%	10.67%	10.70%	12.01%
8/23/1982	2.680	-0.66%	1.33%	7.55%	18.01%	27.47%	40.19%
10/13/1982	2.090	-1.57%	1.84%	3.69%	7.37%	13.48%	24.26%
1/23/1985	1.972	-0.33%	1.18%	1.63%	1.92%	9.62%	15.20%
1/15/1987	2.360	0.30%	3.17%	5.35%	5.15%	17.02%	-5.06%
2/5/1991	2.170	1.94%	4.05%	7.09%	8.20%	9.62%	17.82%
1/6/1992	1.974	-0.13%	-0.87%	-0.98%	-2.96%	-0.99%	3.92%
3/23/2009	2.220	-2.04%	-4.30%	3.30%	8.52%	29.38%	42.68%
7/23/2009	2.170	0.30%	1.07%	5.11%	11.76%	17.82%	12.94%
9/16/2009	2.320	-0.31%	-0.74%	2.60%	4.24%	7.65%	5.23%
3/11/2016	1.800	-0.13%	1.35%	0.98%	4.79%	8.11%	17.33%
7/12/2016	2.180	0.01%	0.54%	1.08%	-0.72%	5.43%	13.53%
1/9/2019	2.370	0.45%	0.98%	4.83%			

Finally, the S&P 500 just registered extreme “overbought” status. This measure considers the number of stocks trading above their medium-term moving average (50 days in this case).

The underlying idea is that “overbought” stocks need time to consolidate after a big run up, but the following table (from LPL Financial) shows that in certain cases, overbought can lead to additional gains, or at the very least, minimal losses up to six months later. Again, this has never triggered inside a bear market:

OVERBOUGHT CAN BE A GOOD THING					
More Than 90% Of S&P 500 Index Components Above 50-Day Moving Average May Mean Strong Equity Returns					
Date	S&P 500 Index Components Above 50-Day Moving Average	S&P 500 Index	1-Month Return	3-Month Return	6-Month Return
02/08/91	94.6%	359.4	3.0%	4.6%	7.7%
06/02/97	90.2%	846.4	5.3%	6.3%	12.9%
03/19/98	90.2%	1089.7	3.1%	1.5%	-6.5%
05/05/03	90.4%	926.6	6.4%	6.1%	13.4%
11/15/04	91.0%	1183.8	1.9%	2.2%	-0.9%
04/30/09	90.6%	872.8	8.0%	13.1%	19.5%
08/04/09	91.2%	1005.7	-1.1%	3.7%	9.1%
03/18/10	90.2%	1165.8	2.7%	-4.3%	-3.5%
10/06/10	91.2%	1160.0	5.3%	10.1%	15.1%
10/25/11	91.8%	1229.1	-5.5%	7.3%	13.9%
01/07/13	90.1%	1461.9	3.4%	7.3%	13.0%
05/15/13	91.2%	1658.8	-1.9%	1.6%	6.6%
03/17/16	90.7%	2040.6	2.6%	1.8%	5.2%
02/19/19	92.5%	2779.8	?	?	?
		Average	2.6%	4.7%	8.1%
		Median	3.0%	4.6%	9.1%
		% Higher	76.9%	92.3%	76.9%
		Count	13	13	13

Source: LPL Research, Bloomberg 02/20/19  
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

## BIGGEST RISKS ARE ACROSS THE OCEANS

With the Fed on hold, the remaining risks to the market are international. China and the potential fallout from Brexit remain the key concerns.

We discussed trade at length in our December Macro Musings and not much has changed in that regard. The United States and China are in continued negotiations, and we expect some sort of resolution in the coming months.

A lot has been written about Brexit, and instead of rehashing the details, we refer you to this article from the BBC. While lengthy and written for residents of the UK, it covers every angle:

<https://www.bbc.com/news/uk-politics-32810887>

Our focus here is on how Brexit may impact the stock market. Although the economy of the United Kingdom is not substantially large (3.3% of global GDP), it is still the 5<sup>th</sup> largest in the world, and the peripheral impacts to other economies, like the remaining countries in the EU, cannot be underestimated.

The biggest worry is the so-called “Hard Brexit”, where the UK leaves the EU on March 29<sup>th</sup> with no deal. This could create tremendous chaos in the short term at borders, ports, and businesses. The economic impact would be immediate.

What is less clear is how this would affect the market. Investors have at least considered the possibility of a Hard Brexit, so the market may have priced this in to a certain extent. Should this scenario come to fruition, we cannot assume that there would be a major selloff. The best evidence for this is how the market reacted when the vote to leave took place.

In late June 2016, the UK voted to leave the European Union. In reaction to the surprising result, the S&P 500 sold off 5% over the next two days. It then proceeded to *rally for the next 32 months* before the next 10% decline.

The fact is that we are in uncharted territory. While the risks are known, the potential impact of the realization of these risks remains unknown. Still, the market reaction to the initial Brexit vote reminds us to not assume doom for equities. As we do with all headline-grabbing events, we will analyze the data and assess the impact through MACROCAST™. If we see continued deterioration, we will take action as needed.

*The chart(s)/graph(s) shown is(are) for informational purposes only and should not be considered as a suggestion of any investment recommendation, investment strategy, or as an offer of advice to buy, sell, or exchange any investment product or investment vehicle. Past performance may not be indicative of future results. While the sources of information, including any forward-looking statements and estimates, included in this (these) chart(s)/graph(s) was deemed reliable, Corbett Road Wealth Management, Spire Wealth Management LLC, Spire Securities LLC and its affiliates do not guarantee its accuracy.*

*The views and opinions expressed in this article are those of the authors and do not necessarily reflect the opinions of Spire Wealth Management LLC, Spire Securities LLC or its affiliates.*

*All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. MACROCAST™ is a proprietary index used by Corbett Road Wealth Management to help assist in the investment decision-making process. Neither the information provided by MACROCAST™ nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. The phrase “the market” refers to the S&P 500 Total Return Index unless otherwise stated. The phrase “risk assets” refers to equities, REITs, high yield bonds, and other high volatility securities. Past performance is no guarantee of future results.*

*Spire Wealth Management, LLC is a Federally Registered Investment Advisory Firm. Securities offered through an affiliated company, Spire Securities, LLC, a Registered Broker/Dealer and member FINRA/SIPC*