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MACRO MUSINGS

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A SMALL CORRECTION AFTER ALL-TIME HIGHS

SUMMARY

- **The MACROCAST™ score continues to suggest low risk of both a recession and major bear market.**
- **After a big rally since Christmas and a new all-time high, the market is in a mild correction. This price action is normal, and often resolves higher in the year ahead.**
- **Despite the shallow nature of the correction, sentiment has tanked. From a contrarian perspective, such a reaction after a decline is bullish.**
- **The trade war with China remains front and center. We believe the impact will be smaller than headlines suggest, but we are monitoring the situation closely.**

THE MARKET IS CORRECTING AFTER A BIG MOVE HIGHER

The S&P 500 is pulling back after a strong rally. After a deep correction last fall, the market rose 25% between December 26 and April 30. As of May 22, it is down marginally, trading around 4% from its all-time highs. We believe this is a normal pullback and not the start of something larger.

History supports this view. When the market reaches a new all-time high after going at least 6 months since the last occurrence, it was higher a year later in all but one instance with average returns of 13%. Historically, over the near-term, there have been several bouts of weaker performance (table from LPL):

CLIMBING THE WALL OF WORRY

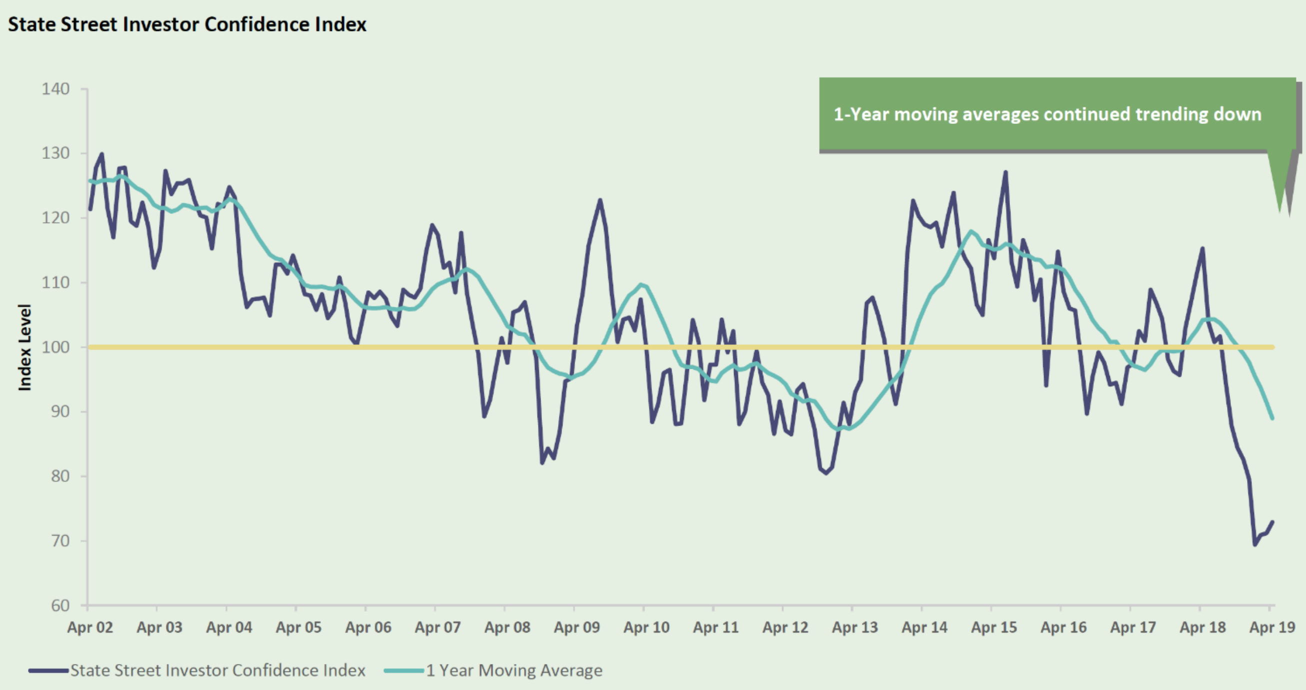
S&P 500 Index Returns After 6 Months Without a Record High				
Date of New Record High	Months Between Records	3-Month Return	6-Month Return	12-Month Return
March 1954	14	6.7%	15.4%	37.7%
September 1958	26	8.4%	12.8%	11.3%
January 1961	18	8.1%	9.9%	12.4%
August 1963	21	1.6%	7.9%	12.9%
May 1967	15	1.6%	0.9%	5.1%
April 1968	7	-0.4%	10.1%	5.4%
March 1972	39	1.6%	2.4%	5.7%
July 1980	90	10.4%	11.6%	8.9%
November 1982	23	5.7%	17.9%	18.8%
January 1985	15	5.6%	13.5%	22.1%
July 1989	23	4.0%	-1.0%	6.4%
May 1990	8	-13.4%	-10.9%	5.8%
February 1991	7	3.1%	6.2%	13.2%
July 1992	6	-0.8%	5.4%	7.6%
February 1995	12	9.1%	15.3%	36.3%
May 2007	86	-2.6%	-5.1%	-8.7%
March 2013	65	1.6%	8.6%	18.5%
July 2016	14	1.4%	6.5%	13.9%
August 2018	7	-7.5%	-2.1%	?
April 2019	7	?	?	?
	Average	2.3%	6.6%	12.9%
	Count	19	19	18
	Higher	14	15	17

Source: LPL Research, Bloomberg 04/23/19
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

SENTIMENT TURNED NEGATIVE RATHER QUICKLY

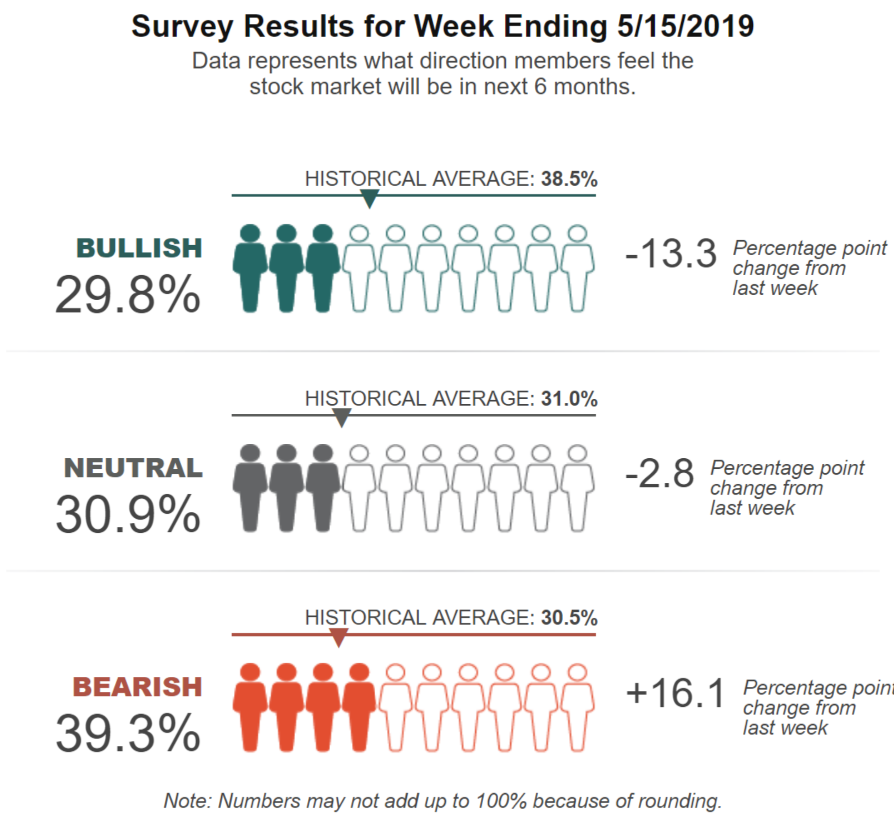
One reason we think new highs will come sooner rather than later is the sudden turn in sentiment. Despite rallying 25% off the lows, and despite the fifth best start to a year *ever* through the month of April, investors are not in a bullish mood. Below we highlight three examples of the increase in negative sentiment, despite a strong economy and rallying markets.

First, a look at State Street's Investor Confidence index. The overall figure is the lowest ever recorded. The smoother one-year average is at levels similar to early 2013, a year when the S&P 500 rallied 30%.



Source: Bloomberg Finance, L.P. As of April 30, 2019.
State Street Confidence Indexes Measures investor confidence or risk appetite quantitatively by analyzing the actual buying and selling patterns of institutional investors. The index assigns a precise meaning to changes in investor risk appetite: the greater the percentage allocation to equities, the higher risk appetite or confidence. A reading of 100 is neutral; it is the level at which investors are neither increasing nor decreasing their long-term allocations to risky assets. The results shown represent current results generated by State Street Investor Confidence Index. The results shown were achieved by means of a mathematical formula in addition to transactional market data, and are not indicative of actual future results which could differ substantially.

Second, while the market is only modestly lower, the weekly survey of the Association of American Individual Investors (AAII) showed a sharp drop in bullishness and rise in bearishness:



Finally, investors have pulled out over *$30 billion* from equity ETFs and mutual funds in the past 4 weeks. In previous instances, short-term outflows of this magnitude have been mostly contrarian signals, leading to strong positive returns a year later.

Taken together, these are not the actions or attitudes of a market that is anything close to euphoric.

TRADE WAR ISSUES REMAIN IN THE NEWS

While the headlines remain concerning, we don't believe recent developments are enough to impact economic growth in a meaningful way for neither China, nor the US. Consider the following:

1) China's GDP from exports to the US (the money they make selling us stuff), is at a 20-year low as a percentage of their total economy.
2) The bulk of the tariffs will be borne by the importer (US companies) and will either be absorbed by the companies (resulting in lower profit margins), or more likely, they'll passed on to the consumer.
3) The estimated dollar impact to the consumer is meaningful but not massive. According to Econofact, the impact of tariffs is in the $300 range for the average household.

More tariffs could be on the agenda, but in the meantime, we will monitor the situation using MACROCAST™, as any impact will be captured by its underlying components. So far, we haven't seen weakness in the indicators that would be affected by the dispute, but we are monitoring the situation closely.