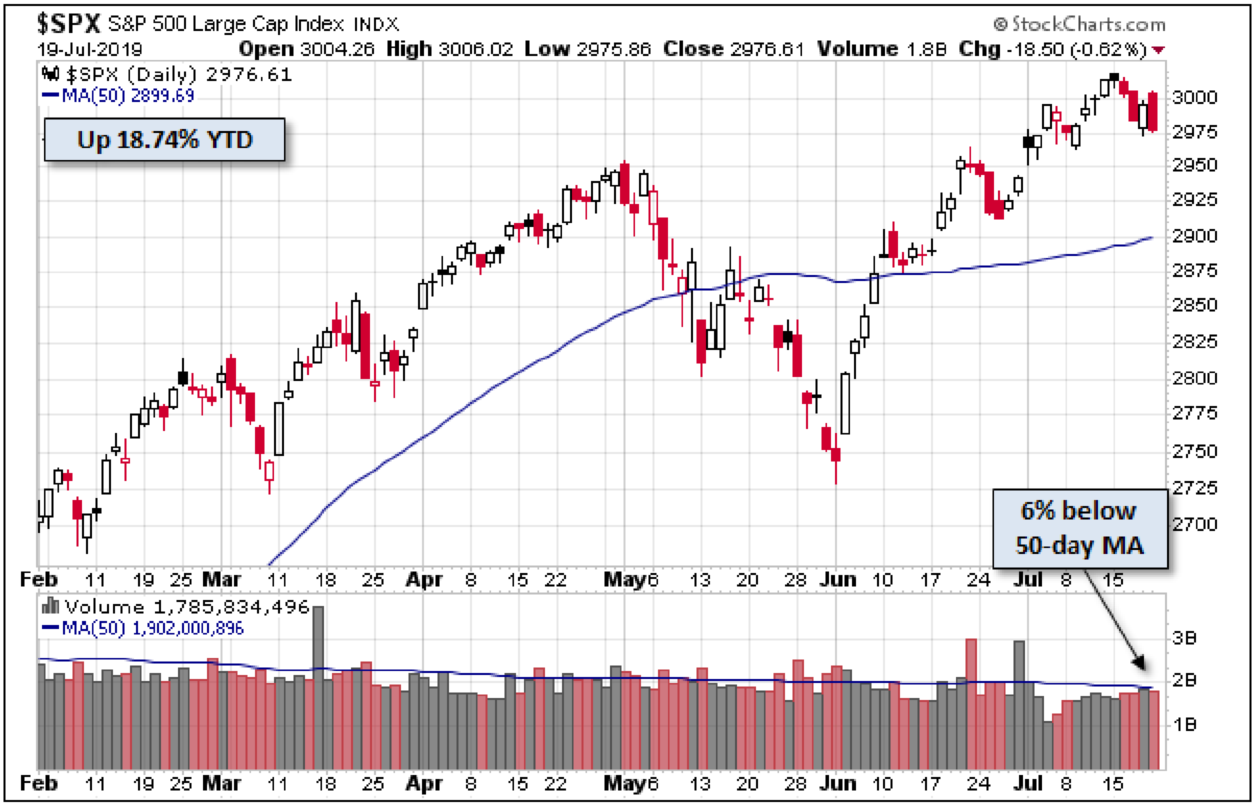
Thoughts from our Chief Investment Officer, Jim Reardon:

All 3 major indexes have passed multiple milestones and posted solid gains in June. The gains were attributed by the media to testimony from Federal Reserve Chairman Jerome Powell that another rate cut was coming.



Source: d.short/ Jill Mislinski 7.12.19 Advisor Perspectives

In July, two stock indexes rose to all-time highs. The Dow Jones Industrial Average closed above 27,000 for the first time and the second week in July brought it its increase to 27,332.03. The S&P 500 index gained 0.5% to end the same day at 3,013.77 notching its first close above 3,000 ever. The S&P closed 1.25% below the record to close the 3rd week Friday. It is up 18.74% Year to Date.

“The Fed is on a one-way street headed to a cut,” Art Hogan, chief market strategist at National Securities recently told Bloomberg News, “The market is clearly in ‘don’t-fight-the-Fed’ mode.”

“You can’t fight the Fed here,” seconded Michael Katz, partner at Seven Points Capital. “We have a strong bull market and we have a strong uptrend. As long as we’re heading higher, we’ve got to keep buying dips and not fight the trend.”

The Fed next decides on interest rates on July 31.

Getty Images
Federal Reserve Chairman Jerome Powell was on Capitol Hill discussing the economic outlook.

Expectations for lower Fed rates persisted despite the release of some stronger-than-expected inflation data. The producer and consumer price indexes — two widely followed measures of inflation — rose more than expected last month. Also, the Labor Department reported stronger-than-expected jobs growth for June.

Ordinarily, this kind of inflationary news might be followed by Fed rate hikes—especially in times where interest rates are already near all-time lows. Historically, the Fed cuts rates—sending interest rates falling, in response to a *crisis*, *recession*, *or both.* If employment is as *"strong"* as the DOL indicates, (which should reflect a strengthening underlying economy) then what concern is the Fed Chairman seeing that causes the lowering of Fed rates at a time when the economy is reported to be booming?

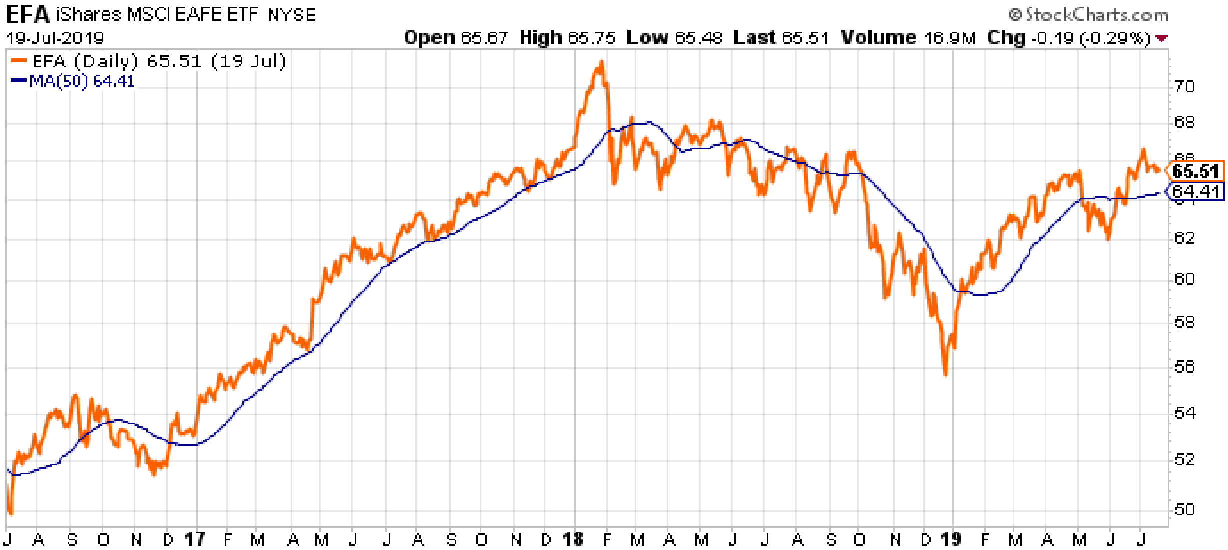
Fed Chair Powell gave this explanation in testimony before congressional leaders:

"Since [the Fed meeting in mid-June], based on incoming data and other developments, it appears that uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the U.S. economic outlook."

These comments give support to a thesis we advanced in our June SITREP:

Currently, we are facing slower global economic growth, the potential of a disorderly "Brexit," "trade wars," an "earnings recession," "negative yields globally," a *potential problem with "Deutsche bank," and geopolitical upheaval.*

International Markets

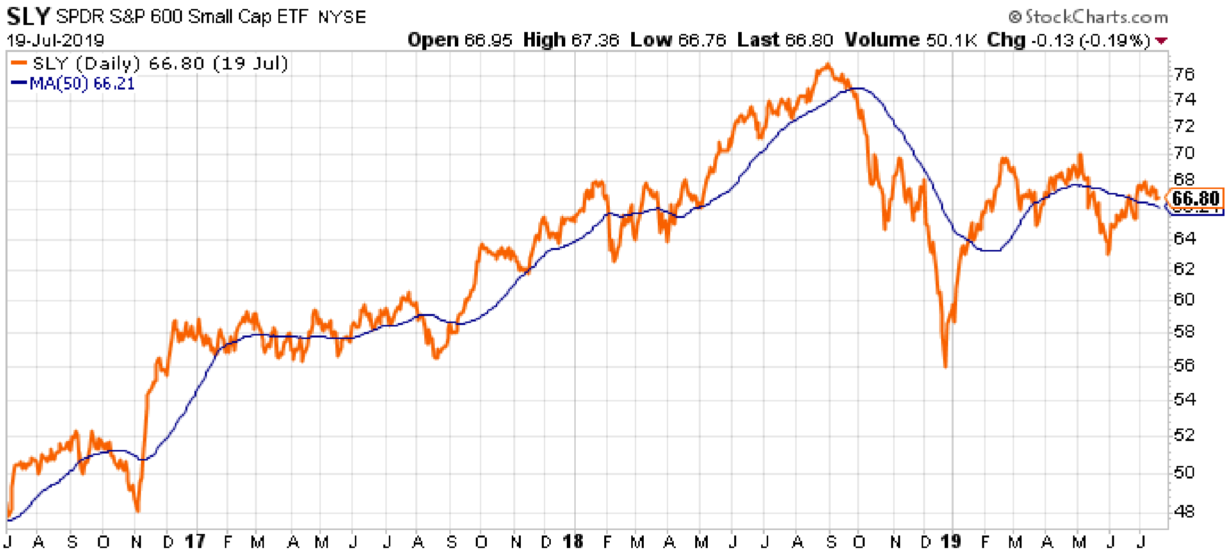


Emerging Markets

There is clearly something amiss within the global economic landscape since every major central bank is now engaged in a similar coordinated infusion of liquidity while international markets continue to remain in a downtrend as the charts (above) indicate.

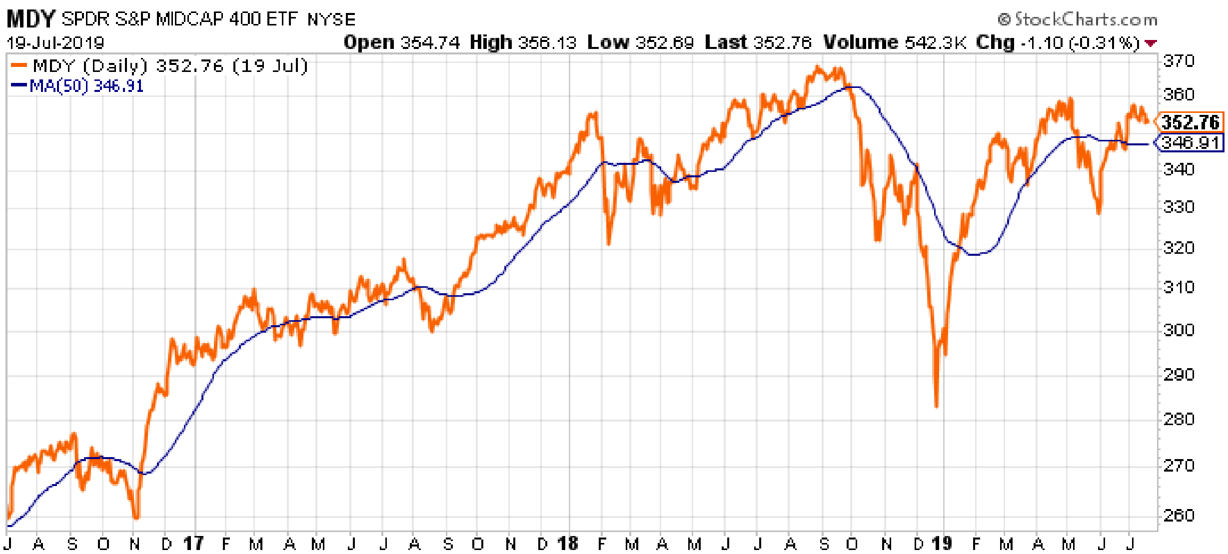
The problem is that despite the inflation of asset prices, and suppression of interest rates, on a global scale there is little evidence that the massive cash infusions are doing anything other than fueling asset bubbles in corporate debt and financial markets. The big question is how to get out of this liquidity trap without cratering the world financial markets in the process.

S&P 600 Index (Small-Cap)



Importantly, US mid and small cap stocks have remained in a downtrend despite the recent surge. Clearly, the rising market tide is not "floating all boats."

S&P 400 Index (Mid-Cap)



The Dow Jones Industrial Average (DJIA) is at an all-time high, but the Dow Jones Transportation Average (DJTA) and Russell 2000 Index remain well below their peaks from last fall.

In fact, the DJTA and the Russell 2000 Index have made lower subsequent highs over the past 10 months, failing to validate new highs in major equity indexes.

About the U.S. Trade Deficit

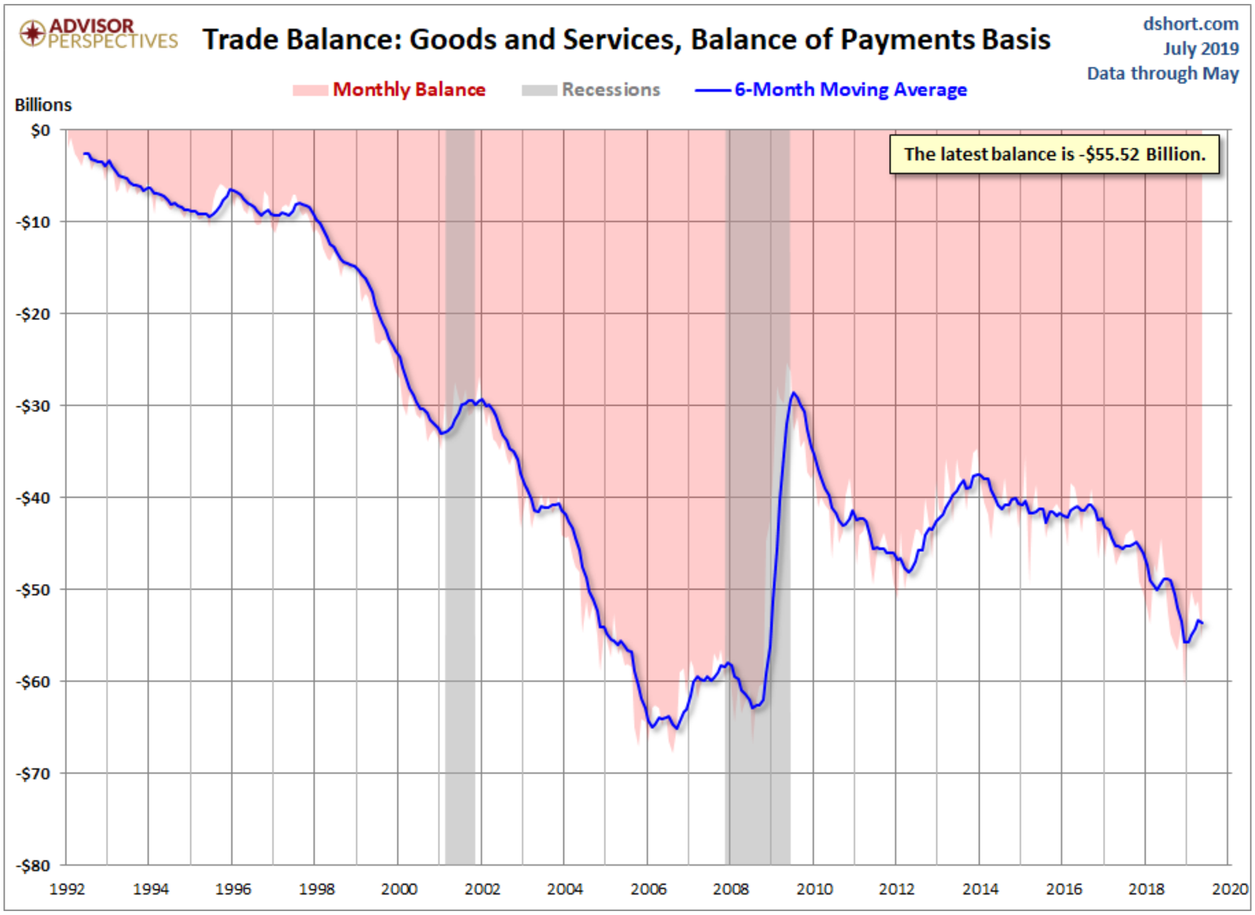


Chart by Doug Short and Jill Mislinski at Advisor Perspectives. 7/3/19

The U.S. International Trade in Goods and Services, also known as the FT-900, is published monthly by the Bureau of Economic Analysis with data going back to 1992. The report details U.S. exports and imports of goods and services. This chart presents data from the report. *Recessions are identified by the gray areas on the chart.

President Trump has consistently singled out the trade gap as a foremost target for his America First policies:

"We have almost an $800 billion a year trade deficit with other nations." "Unacceptable. We are going to start whittling that down and as fast as possible." (November 2017.)

Nevertheless, the U.S. trade deficit soared to a 10-year high in 2018 on the heels of a strong economy, despite the President's ongoing efforts to bring it down through tariffs on $50 billion in imports from China. He has also threatened to raise tariffs on another $200 billion if no progress is made in ongoing negotiations with Beijing.

President Trump also slapped tariffs, (which are a tax on imported goods), on steel and aluminum imports, on some of our other U.S. trading partners—notably Canada.

For 2018, the deficit (which is the difference between the goods and services the U.S. buys from other countries and those it sells to them) grew to $621 billion — the highest since 2008. The trade deficit with China rose to a record $419.2 billion, despite Trump's decision last year to impose tariffs.

The overall trade deficit has grown by $119 billion in the two years since Trump took office according to the Commerce Department. In fact, the deficit is likely to grow despite the President's best efforts, as long as the US economy remains healthy.

The trade gap is growing in large part because the U.S. economy has been strong compared to other major countries. That typically means Americans have the money to buy more from other nations. Also, the dollar strengthened against other currencies in the latter part of 2018, making foreign goods more affordable for Americans. The dollar's climb was partly due to a series of rate hikes by the Federal Reserve.

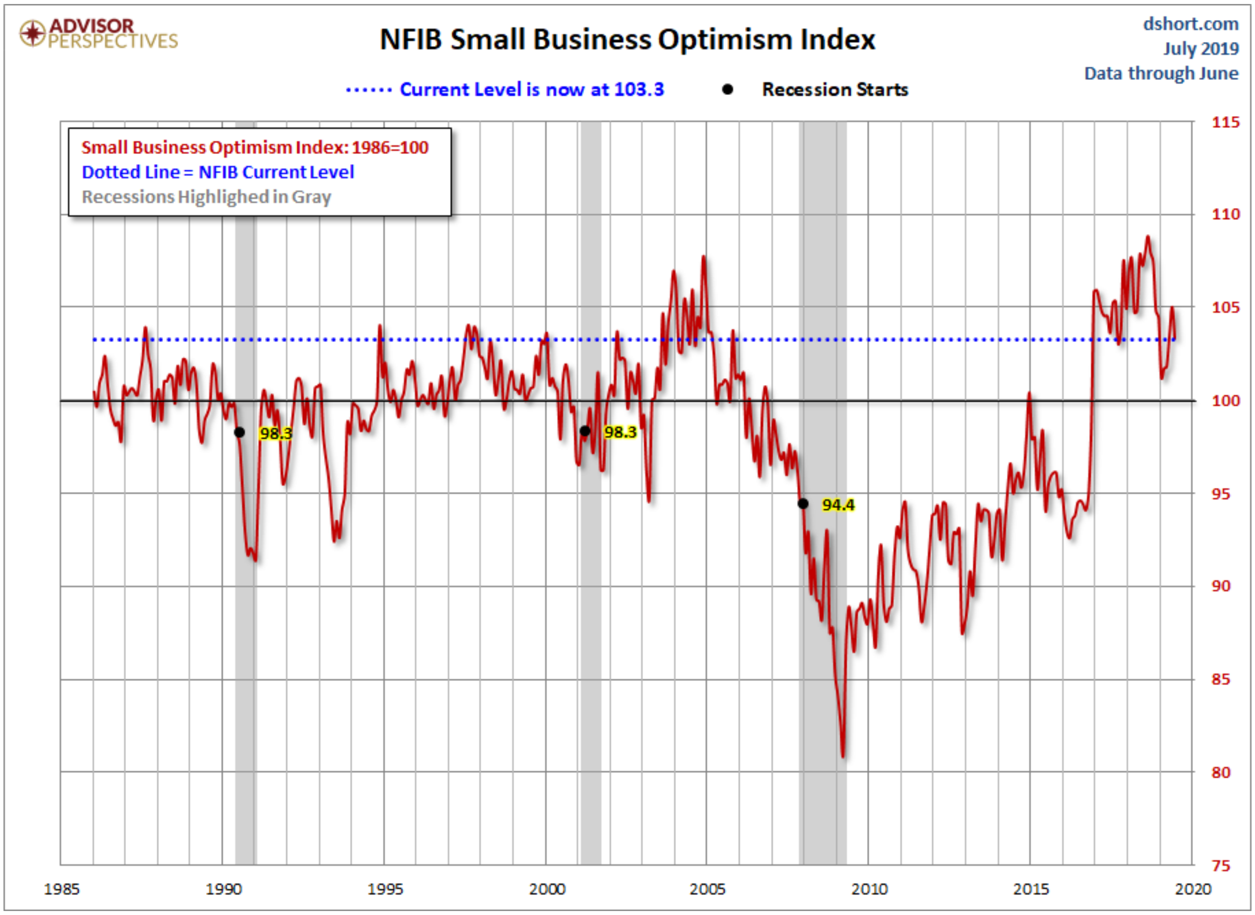
Most economists consider the trade deficit to be a product of our economic strength.

https://www.npr.org/2018/03/28/597688347/america-has-a-large-trade-deficit-but-economists-arent-too-concerned-about-it

They point out that ironically, the administration's tax cuts may have helped to increase the trade deficit by boosting spending on overseas goods by consumers and companies. As the chart clearly indicates, the most effective catalyst to bring down the trade deficit has been a recession* (particularly the Great Recession of 2008 which brought the monthly deficit down by about $30 billion).

Sometimes you need to be careful about what you wish for.

Markets are hopeful that the Federal Reserve has the power to reverse much of the weakening that's taken place in the U.S. economy. History shows that these hopes could be unfounded. The market may continue to make new highs on optimism regarding Fed stimulus, yet it's essential for investors to consider the risks inherent in the macroeconomic environment, as well as the signals being communicated by technical indicators.

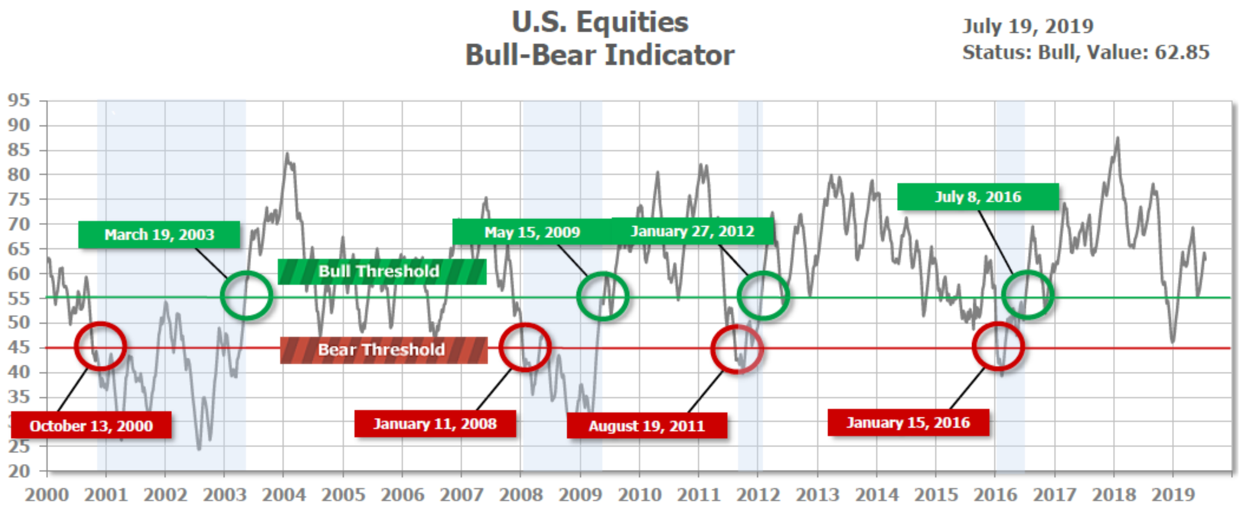


"Last month, small business owners curbed spending, sales expectations and profits both fell, and the outlook for expansion dampened. When you add difficulty finding qualified workers and harmful state level laws and regulations, you're left with a volatile mix where uncertainty has increased to levels not seen in more than two years,"
--NFIB President and CEO Juanita D. Duggan.

Sentiment among the nation's small business owners dipped in June predominantly due to "uncertainty" surrounding the slowdown in global trade and May's stock market tumble. The National Federation of Independent Business (NFIB) small-business optimism index declined 1.7 points to 103.3—missing the consensus forecast of 104.0.

Owners' plans to increase employment and to spend on capital equipment both declined, as well as expectations of higher sales in the future. The NFIB noted increased costs due to tariffs may soon be passed on to customers. The percent of firms raising selling prices rose significantly, with 30% of owners reporting recent changes in China trade policy negatively impacting their business," the group said in its release.

Our Bull-Bear Indicator



The U.S. Bull-Bear Indicator (above) is in Cyclical Bull territory at 62.85, indicating a potential uptrend in the near timeframe.

Our Cyclical Bull-Bear Indictor is like a barometer. It uses 90 different market data points to measure market “pressure.” A high number of positive data points (above 55) are indicative of a strong market. When less than 45 data points are favorable the bear threshold has been crossed and market exposure reduction has usually been the prudent course.

The current Cyclical Bull has taken the US markets to new all-time highs this year. Many of the world’s major indices are currently positive but they have yet to top 2017’s levels. We continue to experience a Cyclical Bull Market in the U.S.

Conclusion

- The medium-term direction (e.g. next 6-12 months) leans bullish.
- Longer term, there is no clear edge in either direction (bullish or bearish).
- The U.S. stock market’s long-term risk to reward ratio is no longer bullish.
- With trade war news flying left and right, we have less conviction for the short term than usual.

Regards,

Your ProActive Capital Management Team

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