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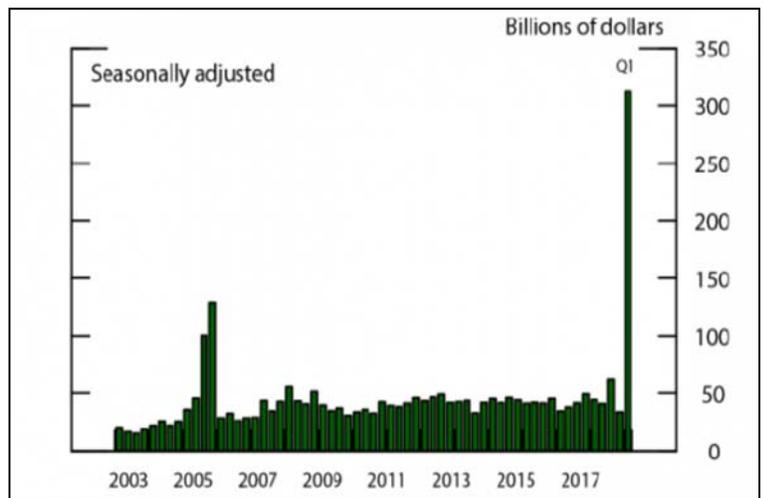
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Market Review & Update

FALL 2018

Well, as we enter the 10th year of this recovery, you may have seen news surrounding the 10 year anniversary of the crisis (we really have become so focused on the negative as a society...). The interviews surrounding the crisis and the aftermath reminds me how little the real truth is evidenced and how politicized the “memorialization” has become. We still see senators become apoplectic shouting the word bailout. And we never give the real picture to the taxpayer of how all this worked. Yes, major financial institutions did receive bailout money, even forced to after first turning it down. For this favor they were often “asked” to absorb companies and the liabilities, thereof, of such noteworthy businesses as Countrywide Financial. (and we should insert here that those senators also passed the enabling legislation to allow things like credit default swaps to be printed...) So, the federal government hands the banks money. In exchange, they take back equity shares in those companies. Every financial institution repaid 100% of the money. And, the part often overlooked, the equity shares rose in value to earn hundreds of billions of dollars for the US taxpayers. The program worked and actually made tons of money. Bernanke, Paulson, Geitner, Kashkari, et al, never really got credit for this magic, but still get lambasted for the “egregious corporate bailout”... I feel compelled to add that there was a company that the government did lose money on their extension of support, General Motors.

So, we’re 10 years into this recovery, and depending how you count, the longest recovery in history. This year began with a major reduction in corporate taxes, including a reduction in tax on the repatriation of foreign funds parked offshore. We spoke of this repeatedly in the past, and that number was rumored to be as much as three trillion dollars. The chart shows that Q1 showed a huge jump in money moving back into the US, spurring buybacks, dividend increases and hiring. Sometimes Washington does something that works. We just completed another earnings period manifesting about 20% year over year earnings growth, about a third of which is attributable to the tax package. Next quarter is likely to do the same. August showed the strongest consumer numbers in about 25 years. Q2 GDP was revised up to 4.2%. And, most surprisingly, August ISM index of factory activity rose to a 14 year high.



Source: The Fiscal Times

The word “tariff” has been blustered about more than anyone would like to hear. But, to this date we have seen several major steps toward renegotiating more beneficial trade agreements. The Euro zone foreign minister has pledged to negotiate a tariff free agreement, and Mexico has theoretically agreed to the specifics of a NAFTA rewrite, which Canada will hopefully join. China is the big dog in this fight. There is a good chance that something productive can be achieved as the economic and political situation in China is not as strong as it was a few years ago which may give China reason to become a productive participant in trade talks.

“Sell in May and go away?” Perhaps 2018 insured the death of that tired market axiom.

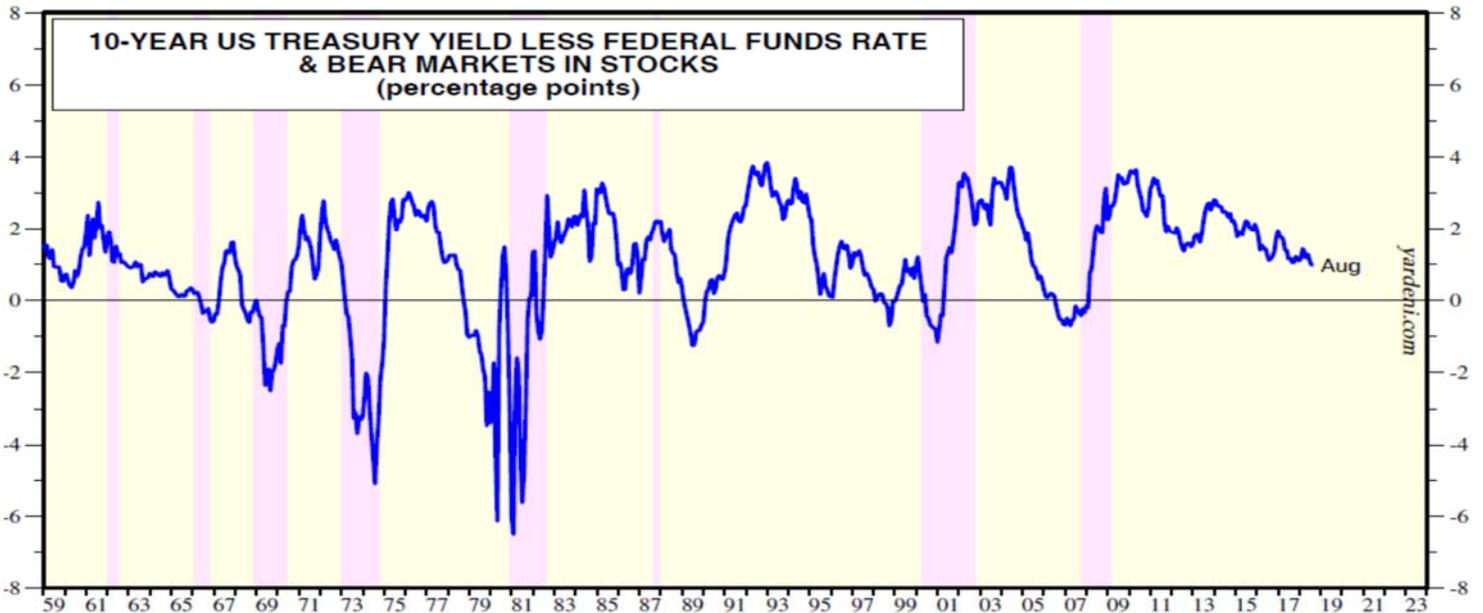
Q3 produced a 7.3% advance for the S&P. It is also the 10th year anniversary of why the markets have rebounded to new highs-EARNINGS. Earnings continue to grow at a rate of 20+% yoy. And while tax cuts go the most press credit, they were only responsible for about 1/3 of the earnings boost. The real hero? You! Sales growth was responsible for more than half of the earnings advance. Consumer sentiment is at a high not seen in decades. Surprising given the moods expressed on cable news and twitter. Consumer strength does not last forever, but the amplitude of this momentum should certainly carry into 2019. Earnings will not repeat the strong double-digit pace of '18, but growth will be present, nonetheless.

Consumer Sentiment



Source: Trading Economics

So, all this good news can only manifest in one forward thinking notion, caution...Yes, he said caution. Lest we drink our own Kool Aid, we must know that most recoveries failed to reach permanent status (sarcasm...), we're in the longest one in our history of tracking, the Fed is in the midst of raising rates, Mario Draghi will join them by next summer. Much has been made of the flattening of the yield curve although we know that the ECB has had an artificial impact that has suppressed the long end of the curve, possibly distorting its relevance. And, we are staring at the mid-term elections, to be followed by general elections just 24 months from them. While we see no weak data at this juncture, we should recognize that the forces are slowly assembling that can increase the probability of a negative event in the future. We do not know the time line, no one does, but it seems to make sense to begin to think about what steps to take to prepare for change. We also seem to have a pretty generous amount of time to think and act. As the Fed would say, "data dependent"...



Note: Shaded red areas denote S&P 500 bear market declines of 20% or more. Yellow areas show bull markets. Source: The Conference Board.

Enjoy the changing leaves! We'll talk to you soon.

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