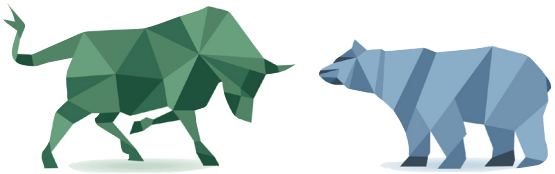
October 8, 2018

Braeburn Observations



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LOWRY'S 10/5/18

There is as yet little evidence to support contentions of a narrowing rally sufficient to produce the Adv-Dec divergences that have historically warned of an approaching major market top. And, attempting to divine the inflection point at which interest rates are high enough to derail the bull market is little better than guesswork. Thus, the probabilities favor the current market weakness as nothing more than a temporary interruption in an ongoing, healthy bull market.

U.S. MARKETS

The major U.S. benchmarks ended the week lower with large-cap indexes holding up substantially better than the technology-heavy NASDAQ Composite and the smaller cap indexes. The Dow Jones Industrial Average gave up just 11 points to end the week at 26,447. The Dow Jones was alone, however. The NASDAQ plunged almost 258 points, or -3.2%, ending the week at 7,788. By market cap, the large cap S&P 500 index gave up -1.0%, while the S&P 400 mid cap index retreated -2.6% and the small cap Russell 2000 plummeted a huge 3.8%.

INTERNATIONAL MARKETS

Canada's TSX ended down -0.8%, while the United Kingdom's FTSE retreated -2.6%. On Europe's mainland, France's CAC 40 gave up -2.4%, Germany's DAX fell -1.1%, and Italy's Milan FTSE was off -1.8%. In Asia, China's Shanghai Composite gained 0.9%, but Japan's Nikkei was off -1.4%. As grouped by Morgan Stanley Capital International, developed markets gave up -2.3% last week, while emerging markets fell a much steeper 4.9%.

U.S. ECONOMIC NEWS

Initial claims for new unemployment benefits returned to a near 49-year low, declining 8,000 last week to 207,000. The reading was far below economists' estimates of an increase of 1,000 to 215,000. The four-week average of claims, which smooths out the weekly volatility, edged up by 500 to 207,000 claims. Hurricane Florence seems to have had a smaller effect on jobless claims than anticipated. Ian Shepherdson of Pantheon Economics stated, "The increase in jobless claims triggered by Hurricane Florence was very modest, and smaller than we expected." Continuing claims, which counts the number of people already receiving unemployment benefits, fell by 13,000 to 1.65 million. That number is reported with a one-week delay.

Payrolls processor ADP reported the U.S. added 230,000 private-sector jobs in September, the most in seven months and well above the consensus forecast of 179,000. In the details of the report, small firms added 56,000 jobs, medium-sized added 99,000, and large companies added 75,000. Year-to-date payroll gains have averaged 204,000 per month, much stronger than the 179,000 average gain over the same time period last year. Services payrolls increased 184,000, led by professional and business services, while goods-producing payrolls climbed 46,000, led by construction. Mark Zandi, chief economist at Moody's Analytics stated in an interview on CNBC, "This labor market is rip-roaring hot, and it is just going to get a lot hotter. The risk that this economy overheats is very high and this is just one more piece of evidence of that."

The unemployment rate fell to a 48-year low of 3.7% in September as nonfarm payrolls expanded by 134,000, according to the Labor Department's monthly Non-Farms Payroll (NFP) report. Of concern, however, is that the payrolls number missed the consensus forecast of 180,000. The headline could be a bit misleading for a couple reasons. First, the number was likely impacted by Hurricane Florence which struck the Carolinas last month and second, the prior two months readings were revised up a total of 87,000, bringing last month's total up to 221,000 jobs on a net basis. Despite the smaller increase in payrolls it was still enough to lower the unemployment rate to its lowest level since December 1969. The bulk of hiring was concentrated in the professional, health care, construction, and manufacturing sectors. White-collar firms added 54,000 jobs and health-care providers filled 26,000 positions. Builders hired 23,000 workers and manufacturers 18,000. Employment fell among retailers, restaurants and hotels. The U.S. has added an average of 208,000 jobs a month through the first nine months of 2018, above the 182,000 pace over the same

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time last year.

Manufacturing activity retreated slightly last month. The Institute for Supply Management (ISM) reported its manufacturing index fell to a reading of 59.8 in September, down 1.5 points from August. Economists had expected a reading of 60.7. Despite the fall, the index remains near its highest level in 14 years and remains in a region historically associated with above-trend economic growth. Fifteen of the eighteen industries reported growth, with primary metals as the only industry reporting contraction. Conversely, research firm IHS Markit reported its U.S. Manufacturing Purchasing Managers Index (PMI) increased 0.9 points to 55.6 last month, its first gain in five months. In the PMI report, both output and new orders growth accelerated to their fastest pace in four months, although export orders flattened.

Services activity, which makes up the vast majority of the U.S. economy, was either at its highest level since August 1997 or at its weakest since January depending on which research firm you ask. The ISM Non-Manufacturing Index jumped 3.1 points in September to 61.6—its second highest reading on record. The increase followed a 2.8 gain the previous month, resulting in a record 5.9 point back-to-back month surge. The consensus was for a -0.5 point decline to 58. Conversely, Markit reported its U.S. Services PMI fell 1.3 points in September, its fourth decline in a row. Markit's report noted that business activity continued its solid expansion, but the rate of growth eased. Chris Williamson, Chief Business Economist at IHS Markit noted, "Service sector business growth has eased considerably since peaking back in May but remains relatively solid. Some of the slowdown can be traced to capacity constraints, with new business once again rising at a steeper rate than firms were able to boost output."

Federal Reserve Chairman Jerome Powell said this week that he did not see signs that inflation would spike despite the historical low unemployment rate. In a speech to the National Association for Business Economics Powell stated, "Many factors, including better conduct of monetary policy over the past few decades, have greatly reduced ... the effects that tight labor markets have on inflation." The comments were in contrast to a long-accepted standard central bank theory known as the "Phillips curve", which posits that tight labor markets lead to higher inflation. The explanation is that employers boost wages to compete for scarce workers and that the rising labor costs ultimately lead to higher costs for consumers. Powell noted that the Fed's 2% inflation target policy seems to have held this phenomenon in check stating "People don't expect higher inflation when they know the Fed will be aggressive to keep prices rising 2%." The Fed's baseline forecast shows unemployment rate remaining below 4% and inflation steady at 2% through the end of 2020.

About Our Research Sources

Barron's – Since 1921 Barron's has provided investment analysis and insight in its weekly publication and, in recent times, it's continuously updated web site. Barron's provides a wide range of perceptives, expert analysis and interviews with financial and investment professionals.

Investor's Business Daily (IBD) – A daily newspaper designed for the individual investor. All of its products and features are based upon the CAN SLIM Investing System developed by its founder William J. O'Neil. This system identifies the seven common characteristics what winning stocks display. For more on this see his book "How to Make Money in Stocks."

Lowry's – Based out of Miami, Florida, Lowry's is the oldest continuously published Technical Investment Advisory service in the US. Their work, which gives insight into the underlying supply and demand dynamics of the market, is based upon a daily examination of all stocks on the New York Stock Exchange and Nasdaq Stock Market. Lowry's has pioneered work in the statistical analysis of upside and downside volume statistics including their exclusive measure of buying and selling pressure.

Mauldin Economics - Best selling author, analyst and financial writer, John Mauldin, taps into his network either directly or through the reams of high-level research he's privy to on a regular basis, to assist in identifying the smartest investments for today's markets; then carefully screened and evaluated by a team of ace analysts.

Stock Trader's Almanac – A unique annual publication created by Yale Hirsch in 1967. The almanac is a treasure trove of insightful research originating such important phenomena as the "January Barometer," the "Santa Claus Rally," and "Sell in May and Go Away." It includes data backing, historically proven, cyclical and seasonal tendencies.

The Fat Pitch - an acclaimed blog that the Business Insider ranks on their annual list of the Top Finance People to Follow. The blog is written by Urban Carmel who has had a long career in financial markets. This blog discusses trends he sees and the business of managing money.

The Sherman Sheet - published by W. E. Sherman and Co., of St. Louis MO. Bill Sherman is a long-time prefessional money manager who developed an in-depth expertise in computerized analysys and statistical measurements over the years, and is a recognized expert in several areas of the investment universe.

Value Line – Founded in 1931, Value Line is an unbiased research firm providing intuitive investment research on companies, industries, markets and economies. Value line provides astute fundamental research, trending information and historical data that allows for shrewd decision making.

Zacks – Founded in 1978 by Len Zacks, PhD. MIT, Zacks is an investment research firm pioneering work in the area of corporate earnings estimate revisions and stock performance. Zacks believes, and Braeburn agrees, that Earnings Estimate Revisions are the most powerful force impacting stock prices.

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