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The Grinch Stole the 2018 Santa Claus Rally

That's right you read the title correctly…the stock market is in a depressed mood, and cannot get out of its own way. For the last 75 days, the stock market has been trading on headlines, and regardless of the many good headlines that are published- the traders in the stock market find a way to poke a hole in the positive news.

There are still 2 weeks left in the year- so perhaps the Grinch will change his heart…but as of now- the stock market looks to have a flat return for 2018.

"Negative Sentiment" is a fancy term which translates to an overall pessimism amongst the typical investment managers. Simply put: the market traders are simply too negative to recognize the positive things going on in the market....as the market trades lower, the negativity in the market snowballs and the market has had a hard time gaining "traction".

The investment strategists are always looking for the next thing that will lead the market lower. Here is the quick list of worries for the stock market, in order of most concern, per Jeff Patterson's opinion:

1. Interest rate uncertainty
2. China Trade War: tariffs will cause retaliation, which will lead to an economic downturn.
3. Peak earnings: "Corporate Earnings are not going to get any better from here"
4. Robert Mueller's investigation will have EPIC Fallout, and the President may get impeached.
5. Washington DC Gridlock: The House and Senate will be at each other's necks and nothing will get done. For instance: a pending Government shut down.

I truly understand how an investment strategist could become negative, after reviewing the above list. But, the market has been dealing with these issues throughout 2018, and we are now seeing some clarity for the top two issues, and the third (in my opinion) is simply too negative.

Consider the following:

- On October 3rd, the transcripts of the September 25-26 FOMC meeting were released. Contained in the release: "Participants generally anticipated that further gradual increases in the target range for the federal funds rate would most likely be consistent with a sustained economic expansion, strong labor market conditions, and inflation near 2 percent over the medium term,". [1]

  This sentiment (along with the interest rate increase) caused the market to go into nervous overdrive, which added to the negative sentiment surrounding the upcoming Mid-Term

[1] https://www.cnbc.com/2018/10/17/fed-points-to-more-rate-hikes-amid-criticism-from-trump.html

Election and the China Trade Talks, ultimately sending the market to down roughly 10%, over the next 30 days.

After the subsequent stock market decline and weakening economic data, on November 28th, the Federal Reserve chairman (Jerome Powell) said "interest rates are just below neutral".[2] I find it amazing how a 10 Trillion Dollar economy can swing in 60 days.

The comments from the Federal Reserve Chairman indicate that the Fed will be slowing their interest rate increases. **Decreasing the interest rate uncertainty.**

- After the China and U.S. delegations shared a dinner at the recent G20 meeting, Larry Kudlow was quoted as saying that the China administration was ready to implement changes "IMMEDIATELY".[3] Since their dinner, the Chinese have announced the following:
  - The increase in tariffs will not go into place January 2019
  - The tariffs on U.S. autos will be reduced down to 15%[4]
  - The Chinese have agreed to purchase soybeans and technology in the amount of $100 billion[5]

  Plainly, the economic tariffs have affected the Chinese economy and they are willing to make concessions to head-off further economic pain. **Decreasing the uncertainty of Trade Risk.**

- In the Third-Quarter 2018 corporate earnings season, annual sales increased by 8.3%, while annual earnings growth was at 25.3%.[6] In conservative fashion, 68% of companies lowered their earnings guidance for the fourth-quarter,[7] it seems that the corporate motto for going forward was "Under Promise, Over Deliver".

  The stock market traders took the conservative guidance as "Peak Earnings", and used the forward guidance as one of the reasons to sell the market off in October.

  The same Peak Earnings rhetoric was said about Caterpillar (CAT) in April 2018. Within CAT's conference call, the company's CFO said: [that the first quarter adjusted EPS] "**will be the high watermark for the year**".[8] The news media completely misintererpted his comment being the peak of the company's performance. To the dismay of the analysts that downgraded CAT on this tagline, Caterpillar reported an increase in EPS of roughly 45% for the third quarter, reported on 10/23/18.[9]

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[2] https://www.cnbc.com/2018/11/28/fed-chairman-powell-now-sees-current-interest-rate-level-just-below-neutral.html

[3] https://www.reuters.com/article/us-usa-trade-china/us-expects-immediate-action-from-china-on-trade-commitments-idUSKBN1O201A

[4] https://www.cnn.com/2018/12/14/business/china-us-auto-tariffs/index.html

[5] https://www.cnn.com/2018/12/13/business/us-soybean-sales-china/index.html

[6] https://navellier.com/get-to-know-us/weekly-marketmail/october-washout-robo-driven-week-of-october-29-2018/

[7] https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121418.pdf

[8] https://www.marketwatch.com/story/caterpillars-stock-falls-as-warning-of-peak-earnings-proved-false-2018-07-30

[9] https://www.investors.com/news/caterpillar-earnings-united-tech-earnings-3m-earnings/

In my view to say that corporate earnings and profits have peaked, on the backdrop of record profits, along with a strong consumer **is simply too pessimistic…**especially if the first two concerns (that I listed) are beginning to have less headline risk.

As Larry Kudlow frequently says, "Profits are the mother's milk for stocks".

- To round out the concern list: the last two bullet points are political in nature, and I will default to the advice of Warren Buffett. He said: **"Never Mix Your Politics with Your Investment Decisions"**.[10] Sage advice…

I never want to be perceived to be a "Perma-Bull"…I have seen too many negative markets to be a Perma-Bull. But, I can also look at the current information and have faith in the trajectory of the overall economy, especially after the recent 10% pullback.

Here are a few factoids which give me the conviction to stay long this market:

- Wages increased 4.6% from September 2017 through September 2018. [11]
- The US unemployment rate is at a 49-year low of 3.7 percent in November 2018. [10]
- Consumer debt is back to the 2008 levels, but mainly due to auto loans and student loan. The consumer credit card debt accounted for 38% of overall debt in 2008; in 2018, credit card debt is 26.2% of the total consumer debt. **Consumers are less leveraged**. [12]
- Revenues and Earnings for 4Q 2018 are now projecting growth rates of 6.5% and 12.8%, respectively. [13]

In closing, given the overall market returns being flat(ish) for 2018, and with the potential for 2019 having less headline risk, I am optimistic that the next few quarters will be positive.

I hope you and your family have a blessed Holiday Season. And, I thank you for allowing me to advise you in the management of your investments.

[10] https://www.youtube.com/watch?v=56R_tMGRq0M

[11] https://tradingeconomics.com/united-states/wage-growth

[10] https://www.thebalance.com/consumer-debt-statistics-causes-and-impact-3305704

[12] https://www.thebalance.com/consumer-debt-statistics-causes-and-impact-3305704

[13]https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_121418.pdf