EverGuide
FINANCIAL GROUP

100 Connell Drive, 2nd Floor
Berkeley Heights, NJ 07922
P (908) 376-3041 M (215) 203-6673 F (908) 264-0723

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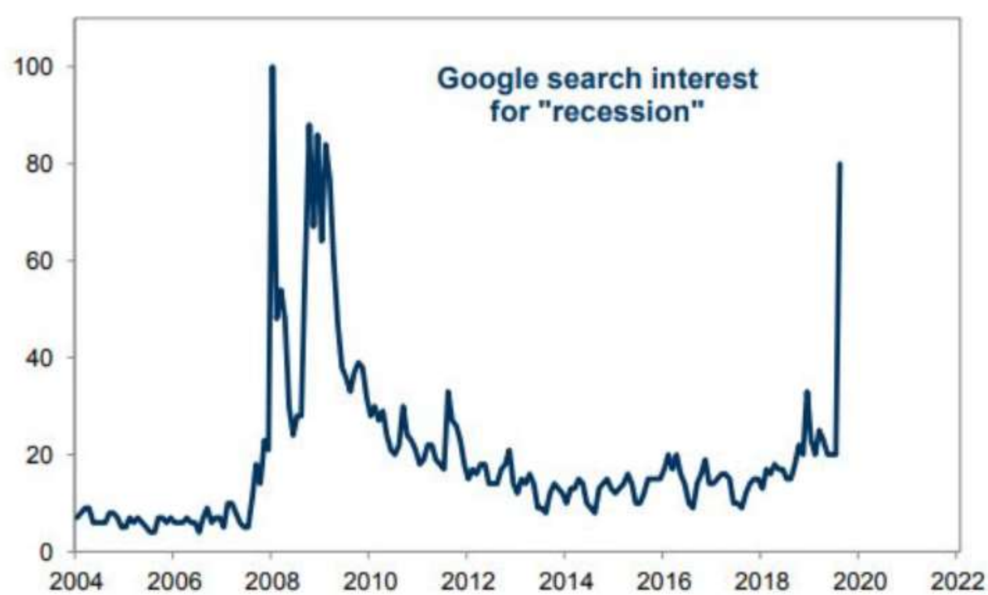
Investor Update

Overall, August saw assets move lower as we had several days where the market was down or up over 1%. Since last fall, even as the market has moved higher the increase in volatility has been noticeable. What is making the market even more tricky right now is how much political positioning is moving markets. I know there has never been a time when a single tweet could move a market the way we are seeing now. While this can be worrisome, it is important to look past these gyrations to see what the real underlying trend is showing for assets across the board.

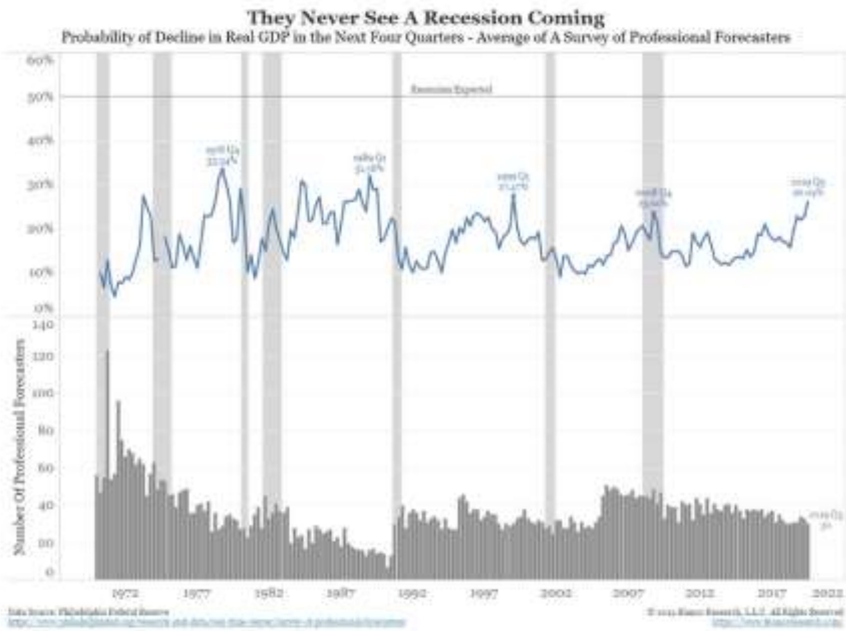
One of the reasons we are seeing the whipsaw of the markets is that the bulls and bears are having a tug of war right now on every piece of data that comes out. The bears have been focusing on global bond yields and a manufacturing recession while the bulls have been focusing on the US consumer and how strong the jobs market is. One thing is for sure, the amount of people talking about recession is on the rise. In fact, the below chart which looks at google searches for “recession” are very telling. The interesting thing is that we didn't see this type of searching until the recession was firmly in place and the stock market was down significantly in 2008.

Exhibit 11: Focus on recession has spiked
as of August 19, 2019

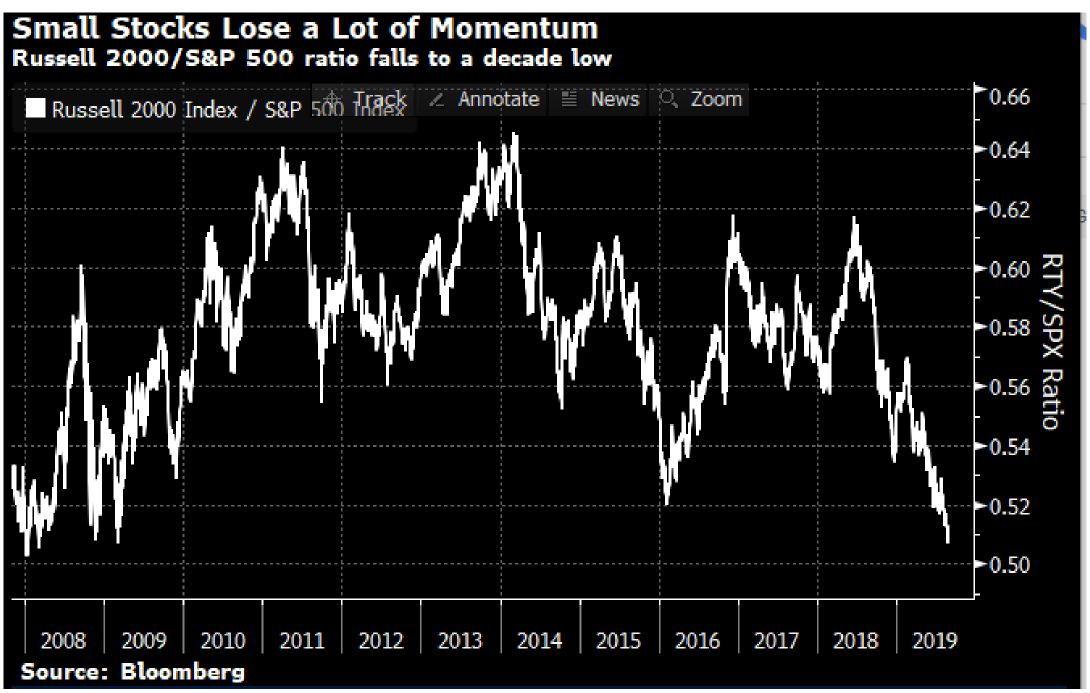


Source: Google, Goldman Sachs Global Investment Research

Another argument that both the bulls and the bears are fighting on right now is the amount of people seeing recession. Some are arguing that the recent uptick in predictors of recession is an indication that we will not have one. Others are saying that we have not even reached 50% of forecasters predicting recession so it is still aways off. In reality, the below chart shows that there are very few that get the recession prediction correct and these arguments should be ignored all together.



One last thing I would like to consider is a deeper look at some of the arguments that are being made on both sides. While the market as a whole is not far from its highs, small caps are underperforming dramatically. With so much of the global weakness being blamed on the trade war, small cap companies have less exposure since they are domestically focused. As you can see below, this has not held up as small cap underperformance has only accelerated.



Interestingly, the bull argument is that financials are dragging down the small cap index as they have more exposure to financials than large cap stocks. As interest rates have dropped and the yield curve flattened, this has caused this underperformance in financials and in turn small caps. At first glance, this makes sense as the small cap index is about 18% financials and the S&P 500 is about 13% financials. However, if you take this a step further to see how small cap consumer companies have done, they have not been the strength as you would expect as shown below. Additionally, they have not even come close to recovering the losses from the 4th quarter of last year. This flies right in the face of the argument that the trade war is causing problems and the US consumer is holding up the whole world. In fact, if you combine the price action of gold and bonds along with small caps vs large caps it is saying that the increase in debt over the last decade is the bigger issue than trade and could cause a larger economic downturn.

Going forward our positioning has continued to get more defensive. Economic indicators are continuing to weaken and the tug of war between bulls and bears may lead to a range bound market for some time. It will most likely take an external catalyst, one that is not being factored by markets currently to push us out of this range to either the upside or downside. In fact, it is our view that the back and forth trade negotiation rumors are masking the underlying weakness and a positive outcome will not necessarily equate to a reacceleration of the economy. Because of this, we are being more cautious with the view that a downside break will be much greater than an upside break. If you have any questions about current positioning and economic indicators please contact me at 908-376-3041.

Sincerely,

Mark R. Painter, CFA