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"By The Way"

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"'Since 1946 the S&P has always been higher 12 months after a mid-term election."

That was an ugly month. It wasn't just the magnitude of the decline, but how fast and relentless it was. The S&P 500 tied an all-time record by not having two consecutive up days over a span of 28 days, and it was only the 19th time the S&P has declined by at least 7.5% within the space of 5 weeks. It is also extremely rare that the market experienced two 10% declines in one year. While we experienced a similar rapid decline earlier this year, for some reason this one feels more ominous to me, although I know not exactly why. Levels of support such as the 200-day moving average have been broken and have now become resistance that the market will have trouble breaking through to re-establish upward momentum. Sentiment readings and the put/call ratio were not negative enough to suggest sellers had been washed out, and in the recent rally the number of stocks participating has been insufficient to conclusively say we have seen the lows. An old investment adage theorizes that the so-called "smart money" operates into the market close, so I am concerned that lately morning rallies have tended to be snuffed out by afternoon selling. There are many positives however; the market did reach oversold levels; this is a seasonally strong time of year; and since 1946 the S&P has always been higher 12 months after a mid-term election. The bottom line is the long term bull trend remains in place, but our level of anxiety is heightened

I will admit to having no strong feeling about what the result of the U.S. elections will be. The outcome will depend on turnout, and which party can muster enough enthusiasm within the ranks to get the vote out. Given the divisive nature of the Trump presidency, one would expect a much higher than normal turnout and early voting is proving that to be the case. A conspiracy theorist could almost make the case that the immigrant "caravan" marching through Mexico was set up by the President to motivate his loyal anti-immigrant followers to get to the polls. As an aside, is it just me that feels that Trump has been around for much longer than two years? While there is likely to be an impact on markets, I believe it will be short-lived and there are larger issues that will be more important. Campaign rhetoric shouldn't be confused with what will be the actual policies put forward post the election. Dan Clifton of Strategas points out that President Obama campaigned in the 2010 mid-terms mainly on a promise to cancel the Bush tax cuts. Reality makes pragmatists of us all. After the Democrats lost 63 seats in the House of Representatives, it took only three weeks for Obama to sign an extension of the tax cut and add a payroll tax

cut to the bill. Like all Presidents, he started thinking about his own re-election and proposed increased economic stimulus (which might explain why the S&P always goes higher in the 12 months following mid-term elections).

The U.S. continues to have the world's strongest economy, despite the Federal Reserve maintaining a policy of higher rates and tighter monetary conditions. Given the strength in the economy and employment, and constrained inflation expectations the FED has no reason to deviate from that path. In addition, corporate earnings remain very strong. There is an argument out there that we have seen the peak in the rate of U.S. growth, although not the peak level of actual GDP or EPS. The thesis is based on the notion that the so-called ''second derivative'' is most important, and that markets will react to a slowing in growth and not wait for an actual decline. I have great sympathy for this concept, but I don't believe we have reached that point as of yet. For example, I was impressed with the 3rd quarter U.S. GDP which was reported at 3.5%, but some pundits are more concerned that the number was below the 4.2% we saw in the 2nd quarter. The question is, when will the market be more concerned about better versus worse as opposed to good versus bad?

It's possible the slowing in the rate of growth will have an impact on the policies of the FED, and may cause the Board to ease its tightening policies which would be positive for markets.

The economies of the other developed nations are experiencing slowing, but still positive growth. The leaders of Europe, Japan and China, like the US President, are also in the business of trying to keep their citizens happy. As such we are seeing those governments enacting fiscal policies to stimulate their economies, which should benefit overall global growth. It is not just economics that is prompting these efforts, but also an attempt to thwart the continuing rise in populism and the "throw the bums out" mind set among the populace. The most recent example is the resignation of Andrea Merkel as party leader in Germany after an embarrassing result in the Bavarian elections, where fringe parties made big gains. Whatever the reason, aggressive fiscal policies are, (at least for the short term until the debt has to be paid back) good for markets.

I remain in the bullish camp with the expectation that after a needed period of consolidation, the market will reassert itself to the upside. Nonetheless, I am more wary than previously, and will await more definitive proof from the economy and especially the market before jumping back in. Attempting to pick the absolute low is usually impossible and often painful. For the time being, I am abiding by an old hunter's motto, "If you don't know, don't shoot".

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