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"By The Way"

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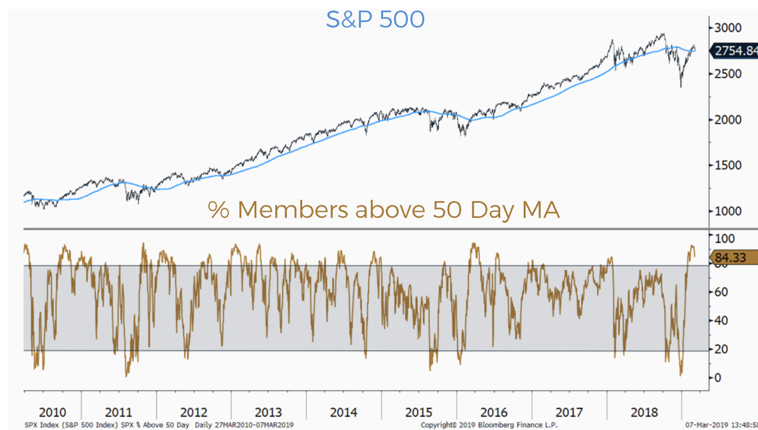
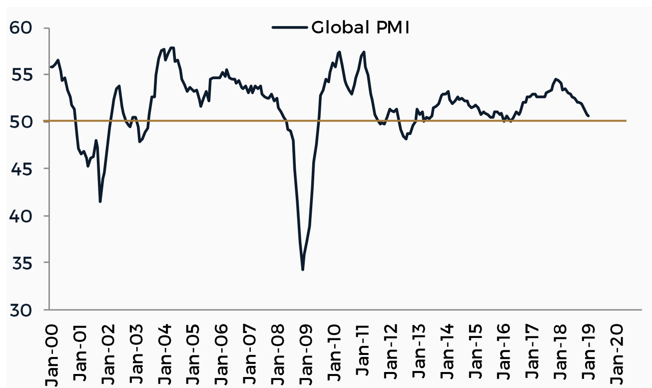
"We can never be sure of an outcome, but I think we can get the odds on our side by understanding where we are in the cycle" – Howard Marks

The S&P 500 Index hardly paused at what I thought was going to be a significant level of resistance between 2600 and 2650, but has now found an increased supply of sellers around 2800. This is not a total shock since the market has retreated from the 2800 level 4 times since the all-time highs of last October. From the Christmas Eve low of 2350 to the recent March 1 top at 2803 the market rose 19.3% in almost a completely straight line. That compensated for the 19.8% decline we experienced in the 4th quarter of last year, or as someone said, "the recent rise was a correction of the correction". Still, the internal strength of the market has been extremely impressive. Measurements such as the advance/decline line and the percentage of stocks above their 50-day moving average give credence to the bull case, that while a period of consolidation is probably required, higher markets are in the offing. The old investment adage, "Don't fight the FED", has again been proven to be correct in the last six months. Taking a longer-term view, the FED first raised rates back in December 2015 and 10 of the last 13 tightening cycles have eventually led to recessions and lower markets.



Given the positive market background, why am I not an all-in buyer? The answer is that while accommodative monetary policy and positive psychology can take markets further than we think possible, at some point weaker economic and earnings fundamentals will affect prices. Howard Marks of Oaktree Capital oversees $120 billion in assets, and a brilliant thinker about markets, recently opined; "We can never be sure of an outcome, but I think we can get the odds on our side by understanding where we are in the cycle". Full disclosure; I'm quoting him since I agree with him in theory and also as to where we are in the current cycle. The economic recovery is advanced in age; the bull market is the same; valuations are not cheap; and fear is at a relatively low level. While global monetary policy can support markets for extended periods of time, stocks can only go so far in an environment where growth is slowing.

The chart below displays a composite of Global Purchasing Managers Indices and gives us a simple overview of the likely future direction of world economic growth. Obviously, the trend is currently down, but it is also nearing the 50 level below which growth is forecast not to just be slowing but in fact to be contracting. Of the major developed economies, the U.S. is the most stable, but the rate of growth both in GDP and earnings has inarguably rolled over. There are two big questions to be answered in the coming year: Can the U.S. continue to grow despite the weakness in the other members of the big four? (China, Europe and Japan); Secondly, will the a current slowdown end in recession, or just a deceleration and rebound later in the year.



At the National People's Congress recently, Premier Li Kepqiang warned that China must prepare for a "tough struggle" and that country faces a "grave and more complicated environment". That does not sound positive for renewed growth.

The European Central Bank admitted in its most recent statement that growth is inadequate in the region, inflation is stagnant, and political risks are high. As a result, the ECB announced there will be no increase in rates until at least 2020, and a new program to encourage lending will be put in place. Again, not a very bright picture.

In Japan GDP has been flat since the mid-90's and the largely unsuccessful war against deflation continues despite massive injections of liquidity. The world's other central bankers must live in fear that, while each economy is different to a degree, such a scenario could be in the cards for them as well, given the inability of current monetary policy to successfully promote inflation and higher growth rates.

Referring back to Howard Marks, while no one can accurately predict when it's time to "get out", it seems to me that we are at the stage of the economic cycle, where caution is appropriate to getting the odds on your side. A quote from Donald Gannon seems fitting in this environment; "when facts are few, experts are many."

I'll wrap up this letter with a few brief references to things that have caught my attention, although I'm not sure of their importance.

I was stunned to watch the Prime Minister of Canada and the President of the United States being openly attacked on nationwide television by supposed allies.

Despite what I considered quite frightening proposals (for investors) by Elizabeth Warren and Bernie Sanders during the 2016 election campaign, they are now considered too moderate for the far-left segment of the Democratic party. As a result, the two seem to be becoming more radical to win the support of that faction.

Stocks have outperformed commodities since 2011 and look likely to continue to do so, but a contrarian might be intrigued to see this headline; "Goldman Sachs is set to cut commodity staff". Such events often presage a change.

Finally, as I have noted, this is the Chinese Year of the Pig, so isn't it remarkable and apropos that the best performing stock on the Shanghai Exchange is Muyuan Foodstuff Co,. a pork processor. Fueled by fears of African Swine Fever, the stock was up 85% at the end of February.

As we look out at the remainder of 2019 we must ask; will central bank accommodative monetary policies be sufficient to support stocks until economic growth reaccelerates.

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