

Weekly Market Notes

January 16, 2018

Dow Industrials 25803
S&P 500 2786



Please refer to Appendix – Important Disclosures

Stock Market

The popular averages soared to new record highs last week. The Dow Industrials have risen a remarkable 1000 points since the start of the year. Surging optimism due to the rapid expansion of the U.S. economy has encouraged corporate earnings estimates to be revised upward. Fourth-quarter corporate earnings reports begin to flow this week and consensus forecasts of analysts show S&P 500 earnings expanded 10% to 14%. A flood of reports that business is raising wages and providing bonuses based on the reduction of corporate taxes from 35% to 21% has added to the newfound optimism on Main Street. Entering the new week the equity markets are technically overbought with most sentiment indicators showing excessive investor optimism, a contrary indicator. This is seen in the Ned Davis Research Crowd Sentiment Index that reached a new record high last week. The caution message issued by the sentiment indicators, however, is offset by the fact that negative divergences that often precede a market decline are absent in the present example. The current rally is broad based with nearly all areas in harmony with the primary trend. Typically at an important peak in the market the leadership begins to grow thin, which is opposite of what we are witnessing now. This argues that any weakness that could develop will be limited in time and price.

Summary

Economy: December inflation reports show pricing pressures contained; retail sales in Q4 surge at 11% annual rate, best in seven years

Fed Policy: Inflation data allows Fed to raise rates at a measured pace

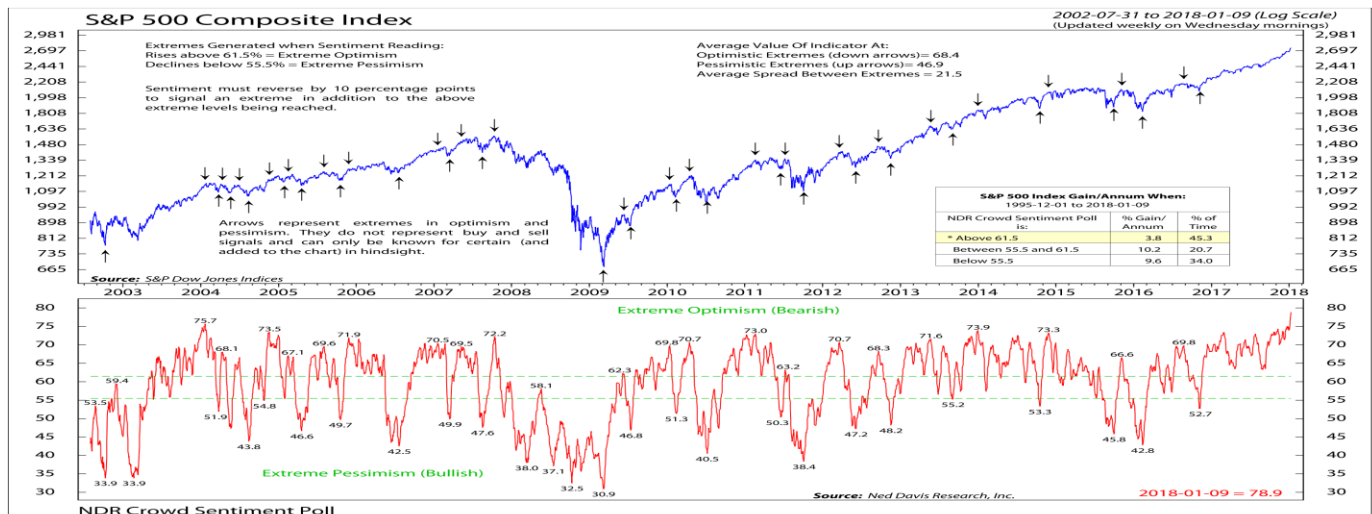
Sentiment: Investor Optimism widespread and excessive

Strongest Sectors: Financials, energy, materials and consumer discretionary

New funds should be directed to the strongest sectors including consumer discretionary, materials, energy and financials. Consumer stocks benefit from the combination of a lower corporate tax rate and increased disposable income provided by higher wages and the proliferation of worker bonuses in 2018. Commodity-related areas are benefiting from improving trends in the global economy. This would include the materials and energy sectors and precious metals stocks. The financials are benefiting from the rising rate theme that is anticipated to continue.

Economy, Inflation & Interest Rates

The U.S. economy is benefiting from a surge in consumer spending that has caused economists to raise fourth-quarter GDP estimates to 3.3%. The Citicorp Economic Surprise Index is hovering near the high for the cycle, which suggests that the momentum generated by the economy in 2017 will carry into 2018. As a result of the new tax legislation, business spending is expected to pick up the baton from the consumer in 2018. Despite the improving economic trends, inflation by most measures has yet to break out to the upside. On a year-over-year basis CPI inflation moved down to 2.1% from 2.2%. Core inflation (less food and energy) moved up to 1.8% from 1.7%. The data shows inflation is presently contained providing the Fed no urgency to accelerate its move to normalize interest rates. At this juncture the markets are pricing in two and perhaps three rate hikes by the Fed this year. We do not anticipate the equity markets will be negatively impacted unless the Fed is forced to raise rates more than three times or the yield on the benchmark 10-year Treasury note rises above 3.00%.



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Sentiment

| | Current Week | | Previous Week | | Indication |
|--|--------------------|----------------|--------------------|----------------|------------|
| CBOE 10-Day Put/Call Ratio <i>Below 83% is bearish; Above 95% is bullish</i> | 82% | | 95% | | Bearish |
| CBOE 3-Day Equity Put/Call Ratio <i>Below 57% is bearish; Above 67% is bullish</i> | 54% | | 54% | | Bearish |
| VIX Volatility Index <i>Below 11 is bearish; Above 20 is bullish</i> | 10.1 | | 9.2 | | Bearish |
| American Association of Individual Investors <i>Twice as many bulls as bears is bearish; 2X more bears than bulls is bullish</i> | Bulls: Bears: | 48.7% 26.3% | Bulls: Bears: | 59.8% 15.6% | Neutral |
| Investors Intelligence (Advisory Services) <i>55% bulls considered bearish/more than 35% bears is bullish</i> | Bulls: Bears: | 64.4% 13.5% | Bulls: Bears: | 61.9% 15.2% | Bearish |
| National Assoc. of Active Investment Mgrs. (NAAIM) <i>Below 30% is bullish; Above 80% is bearish</i> | 58% | | 59% | | Neutral |
| Ned Davis Research Crowd Sentiment Poll | Record Optimism | | Optimism Excessive | | Bearish |
| Ned Davis Research Daily Trading Sentiment Composite | Optimism Excessive | | Optimism Excessive | | Bearish |

| | RS Ranking | | | RS Trend | Sub-Industry Detail |
|-------------------------------|------------|----------|----------|----------|--|
| | Current | Previous | Previous | | |
| Consumer Discretionary | 1 | ** | 1 | | <i>Leaders:</i> Auto Parts & Equipment; Homebuilding; Publishing; Internet Retail; Department Stores; General Merchandise Stores; Computer & Electronics Retail; Home Improvement Retail <i>Laggards:</i> Household Appliances; Housewares & Specialties; Leisure Products; Specialized Consumer Services |
| Financials | 2 | ** | 2 | | <i>Leaders:</i> Consumer Finance <i>Laggards:</i> Insurance Brokers; Multi-Line Insurance; Industrial REIT's; Office REIT's; Residential REIT's; Retail REIT's; Specialized REIT's |
| Energy | 3 | ** | 3 | + | <i>Leaders:</i> Oil & Gas Refining & Marketing <i>Laggards:</i> |
| Information Technology | 4 | ** | 5 | - | <i>Leaders:</i> Electronic Equipment & Instruments <i>Laggards:</i> |
| Industrials | 5 | | 6 | | <i>Leaders:</i> Aerospace & Defense; Construction Machinery & Heavy Trucks; Trading Companies & Distributors; Air Freight & Logistics; Railroads; Trucking <i>Laggards:</i> Industrial Conglomerates |
| Materials | 6 | ** | 4 | | <i>Leaders:</i> Commodity Chemicals; Steel <i>Laggards:</i> Metal & Glass Containers |
| Health Care | 7 | | 8 | | <i>Leaders:</i> <i>Laggards:</i> |
| Consumer Staples | 8 | | 9 | | <i>Leaders:</i> Personal Products <i>Laggards:</i> Brewers; Agricultural Products; Packaged Foods & Meats; Tobacco; Household Products |
| Telecom Services | 9 | | 7 | | <i>Leaders:</i> <i>Laggards:</i> |
| Utilities | 10 | | 10 | | <i>Leaders:</i> <i>Laggards:</i> Electric Utilities; Multi-Utilities & Unregulated Power |

** Denotes Current Relative Strength-Based Overweight Sectors

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