

Weekly Market Notes

August 13, 2018

Dow Industrials 25313
S&P 500 2833



Please refer to Appendix – Important Disclosures

Stock Market

The equity markets suffered modest losses last week due to a surge in volatility in the world currency markets. Stocks struggled with the prospects that the turmoil in the Turkish and Russian currencies could spread to other areas such as occurred in the late 1990s. This boosted the U.S. dollar to rally to a one-year high, raising concerns that S&P 500 earnings could be negatively impacted as the profits of multinational companies are diluted when translated back to dollars. A strong dollar can be a positive force for the stock market as it attracts foreign investment and reduces import costs and has deflationary implications, which helps the Fed maintain a policy of a measured approach to raising interest rates. The bottom line is that the volatility seen in overseas currency markets does not change the immediate picture for the stock market. The market continues to be driven by improving economic conditions. This is underscored by a report last week showing confidence among small businesses at an all-time record high, which bodes well for continued strength in the labor markets. The largest negative on the horizon is the reluctance of either the U.S. or China to back down from tariff threats, which could eventually lead to a slowing of global economic growth. Over the near term, we view the risk in the stock market to be 2775 using the S&P 500 Index with the likelihood that stocks remain in a trading range in the third quarter.

The technical indicators of the stock market remain mixed. Measures of investor psychology are neutral on balance. Put/call ratios are near-term bullish but the various surveys offer mixed messages with the latest data from the American Association of Individual Investors showing the bulls and bears nearly equal weighted. There was a sharp increase in the professional money managers allocation to stocks to 87% from 76% the previous week according to the National Association of Active Money Managers (NAAIM). Stock market breadth remains problematic. Seven of the S&P 500 sectors were down at mid-year but only the Utilities has climbed back up 1.00% for the year according to Ned Davis Research. The four sectors that account for all of the gain in the S&P 500 are technology, consumer discretionary, health care and energy. Also, since May, defensive sectors have outperformed cyclicals and we continue to recommend diversification into health care, utilities and consumer staples entering the seasonally weak period of August through early October.

Despite the rapid rise in corporate earnings in 2018, valuations remain historically high. The median price/earnings ratio for the S&P 500 is 23.8X. This is quite a bit above the 54-year norm of 17.1X. The S&P 500 median price/sales ratio is at an all-time record high suggesting that much of the growth in revenues going forward is already built into current prices. We should emphasize, however, that valuations metrics are not a good tool for predicting the future direction of the stock market but they do offer valuable insight when measuring risk, which could be important given the Fed is raising interest rates and the history of stocks struggling in front of mid-term elections.

Summary

Currency concerns likely overstated -- Strong dollar hurts multinationals but helps small domestic businesses

Small business optimism soars to record high -- bodes well for job growth

CPI, on year-over-year basis up 2.9% -- fastest pace since 2011

Latest inflation data will keep the Fed on path to normalizing interest rates – next meeting scheduled September 25 & 26

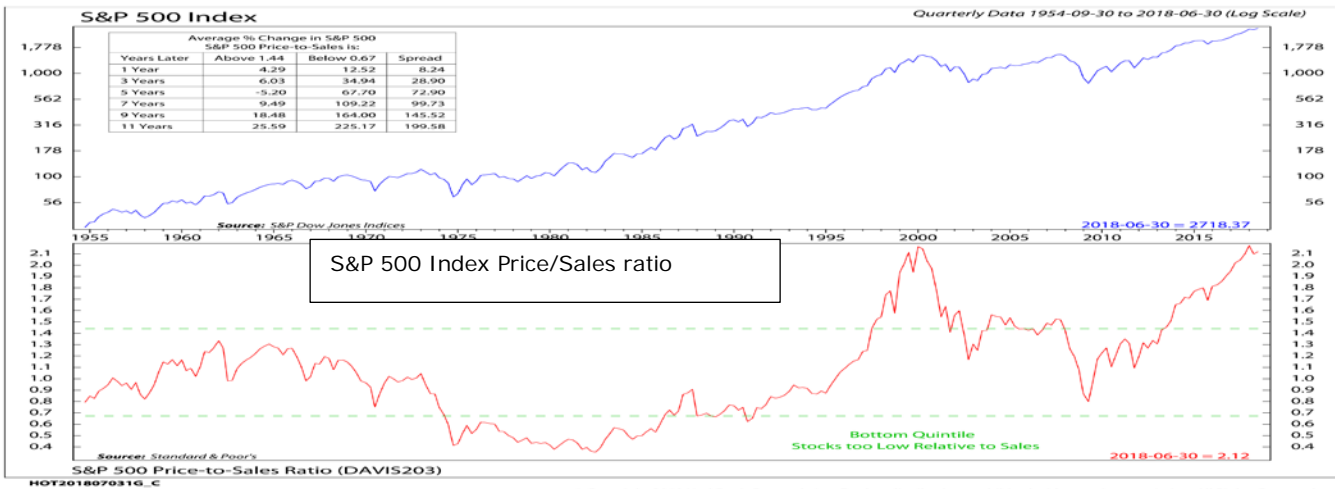


Chart provided by Ned Davis Research

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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>	99%		93%		Bullish
CBOE 3-Day Equity Put/Call Ratio <i>Below 55% is bearish; Above 65% is bullish</i>	64%		60%		Neutral
VIX Volatility Index <i>Below 11 is bearish; Above 20 is bullish</i>	13.1		11.6		Neutral
American Association of Individual Investors <i>Twice as many bulls as bears is bearish; 2X more bears than bulls is bullish</i>	Bulls: Bears:	29.1% 32.1%	Bulls: Bears:	31.5% 26.9%	Neutral
Investors Intelligence (Advisory Services) <i>55% bulls considered bearish/more than 35% bears is bullish</i>	Bulls: Bears:	54.5% 18.8%	Bulls: Bears:	54.9% 18.6%	Neutral
National Assoc. of Active Investment Mgrs. (NAAIM) <i>Below 30% is bullish; Above 80% is bearish</i>	87%		76%		Bearish
Ned Davis Research Crowd Sentiment Poll	Optimism Excessive		Optimism excessive		Bearish
Ned Davis Research Daily Trading Sentiment Composite	Optimism		Optimism		Neutral

	RS Ranking			RS Trend	Sub-Industry Detail
	Current	Previous	Previous		
Health Care	1	**	1		<i>Leaders:</i> Health Care Facilities; Managed Health Care; Life Sciences Tools & Services <i>Laggards:</i> Health Care Distributors
Consumer Discretionary	2	**	3		<i>Leaders:</i> Footwear; Internet Retail; Department Stores; General Merchandise Stores; Automotive Retail <i>Laggards:</i> Tires & Rubber; Automobile Manufacturers; Home Furnishings; Household Appliances; Housewares & Specialties; Casinos & Gaming; Hotels, Resorts & Cruise Lines; Advertising
Information Technology	3	**	2		<i>Leaders:</i> Systems Software; Electronic Equipment & Instruments; Electronic Components <i>Laggards:</i> Electronic Manufacturing Services
Telecom Services	4		9	+	<i>Leaders:</i> <i>Laggards:</i>
Financials	5		7		<i>Leaders:</i> <i>Laggards:</i> Asset Management & Custody Banks; Multi-Line Insurance
Utilities	6		5		<i>Leaders:</i> <i>Laggards:</i>
Consumer Staples	7		6	+	<i>Leaders:</i> Food Distributors; Agricultural Products <i>Laggards:</i> Brewers; Personal Products
Energy	8		8	-	<i>Leaders:</i> Oil & Gas Refining & Marketing <i>Laggards:</i> Oil & Gas Equipment & Services
Materials	9		10		<i>Leaders:</i> Fertilizers & Agricultural Chemicals <i>Laggards:</i> Construction Materials; Paper Packaging; Gold
Industrials	10		4		<i>Leaders:</i> Construction & Engineering; Trading Companies & Distributors; Diversified Support Services; Human Resources & Employment Services; Railroads <i>Laggards:</i> Industrial Conglomerates; Construction Machinery & Heavy Trucks

** Denotes Current Relative Strength-Based Overweight Sectors

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