Soundings

What's New – January 2019

Quote of the month:
"There is no definition of a successful life that does not include service to others." George H. W. Bush

The only modern U.S. President to NOT write a memoir, when 41 passed, we heard many a story of what defines a truly good human being. Ron Rowe, U.S. Secret Service Deputy Assistant Director, shared the time in 2013, when Timberwolf (GHWB's callsign) learned that the two-year old son of one of his Secret Service agents was battling leukemia. Childhood leukemia had touched the Bush's in the past. Their three-year old granddaughter, Robin, lost her battle in 1953. Without a second thought, the President joined the rest of the security detail and shaved his head bald in solidarity with the boy's fight. Quite a Google-worthy picture and just one example of a life well-lived.

I don't have to tell you 2018 was a hell of a year. While January was of the best on record, December was the worst since 1931. When the music stopped, all major averages finished the year solidly in the red, their worst performance since the great recession. So what happened? Analysts attribute a combination of trade tensions, Fed-speak, government dysfunction, geopolitics, and talk of slower earnings growth, among the contributors. As always, the market can do anything on a day to day basis. Where it lands when the dust settles is a matter of future earnings projections. At present, the base case suggests this correction is potentially overdone.

To that point, it's January and time for the brave to make their forecasts for 2019. This is a sport for gladiators for those who step into the arena, put it all on the line in a most public fashion. In this month's M*arket & Economic Commentary*, I've placed a piece from First Trust's Chief Economist, who's steps boldly into the forum with his unadulterated projection. Give it a read, it's worth the time. First, the numbers...

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Market Update – Year to Date Returns

Major Stock Indexes	(As of 12/31/18)*
Dow Jones Industrials	-5.6%
S&P 500 Index	-6.2%
NASDAQ	-3.9%
DJ Global ex US	-16.5%
Russell 2000 (small cap index)	-12.2%
XAU (gold/silver)	-17.1%
Major Bond Indexes	
Broad Market – Barclays Capital Aggregate	0.1%
High Yield Corporate - Barclays Capital	-2.3%
Municipal Bond - Barclays Capital	1.2%
Lipper Mutual Fund Categories	
Large Cap Growth	-0.4%
Large Cap Value	-7.6%
Small Cap Growth	-4.1%
Small Cap Value	-15.8%
International	-14.8%
Balanced Fund	-4.5%
US Govt Bond	0.9%
Corporate A-Rated Bond	-1.9%

*** Source: The Wall Street Journal**

Other Disclosures

- Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect investment performance. Individual investor's results will vary. The S&P 500 is an unmanaged index of 500 widely held stocks that's generally considered representative of the US stock market. The NASDAQ Composite is an unmanaged index of securities traded on the NASDAQ market. The Russell 2000 index is an unmanaged index of small cap which generally involve greater risks. The Dow Jones Industrial Average (DJIA), commonly known as the "Dow", is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. The DJ Global ex US is an unmanaged group of non U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.
- Lipper Indexes are based on the largest funds within the same investment objective and do not include multiple share classes of similar funds. The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity. The Barclays Capital US Aggregate Corporate Index (B) is an unmanaged index composed of all publicly issued, fixed interest rate, nonconvertible, investment grade corporate debt rated BAA with at least 1 year to maturity. The Barclays Capital Aggregate Index measures changes in the fixed rate debt issues rated investment grade or higher by Moody's Investors Service, Standard & Poor's, or Fitch Investors Service, in that order.The Aggregate Index is comprised of the Government/Corporate, the Mortgage-Backed Securities, and the Asset-Backed Securities indices. The Philadelphia Gold and Silver Index (XAU) is an index of sixteen precious metal mining companies that is traded on the Philadelphia Stock Exchange. The information contained in this report does not purport to be a complete description if the securities, markets, or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete, it is not a statement of all available data necessary for making an investment decision, and it does not constitute a recommendation.. Any opinions are those of Jon Kagan and not necessarily those of RJFS or Raymond James Financial. Expressions of opinion are as of this date and are subject to change without notice. This information is not intended as a solicitation or an offer to buy or sell any security referred herein. There is no assurance any of the trends mentioned will continue in the future. Investing involves risk and investors may incur a profit or a loss, including the loss of all principal. Past performance may not be indicative of future results. Asset allocation does not guarantee a profit nor protect against loss.
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Market & Economic Commentary

Early in 2018 we said the US economy has gone from Plow Horse to Kevlar. Nothing that has been thrown at it since is likely to pierce that armor. A year ago consensus was that real GDP would grow 2.5% in 2018. By contrast, we were more optimistic, projecting that real GDP would be up 3.0% in 2018. If we plug in our forecast for 2.0% real GDP growth in the fourth quarter, the economy will have grown 2.9% for the year. If we use the Atlanta Fed's estimate of 2.7% for Q4, we'd get 3.1% for the year. Either way, we just about nailed it.

Now, the same consensus that a year ago suggested the economy would only grow 2.5% in 2018 is saying the economy is going to slow down to a pace of 2.3% in 2019, in part because of the supposed reduction in stimulus related to the 2018 tax cuts. Once again, we're not buying it. The benefits to growth from a lower tax rate on corporate profits and less regulation are going to take years to play out. Companies and investors around the world have only begun to react to the US being a more attractive place to operate. As a result, we're forecasting another year of 3.0% economic growth. Further, we expect the jobless rate to keep gradually falling, down to 3.3%, the lowest since the early 1950s. Last year the consensus predicted the jobless rate would decline to 3.8% in 2018; we predicted 3.7%. Right now it's already 3.7% and we think a drop to 3.6% is likely for December when that report comes out January 4.

On inflation, it looks like we'll finish 2018 with the Consumer Price Index up about 2.0%, although it would have been higher were it not for what we think is a temporary downdraft in oil prices. The consensus had projected 2.1% and we had been forecasting 2.5%. Look for a rebound in oil prices and ample monetary liquidity to help push the CPI gain to 2.5% in 2019, which would be the largest gain since 2011. The tricky part is what to expect from the Federal Reserve in 2019. Based on our economic projections, and if the economy were the Fed's only consideration, we could get as many as four rate hikes in 2019. But we think the Fed will have a two-part test for rate hikes in 2019. First, as we just explained, the economy itself. Second, the yield curve. We think the Fed will be very reluctant to see the federal funds rate go above the yield on the 10-year Treasury Note and will strive to avoid either an active or passive inversion of the yield curve. An active inversion would be the Fed directly raising the federal funds rate above the 10-year yield; a passive inversion would be raising the federal funds rate so close to the 10-year yield that normal market volatility could send the 10-year lower than the funds rate. As a result, we think the Fed will want to leave a "buffer zone" between the 10-year and the funds rate of about 40 basis points. So, for example, if the 10-year yield stays near its current level throughout all of 2019, we could end up with no rate hikes at all in spite of economic conditions. Our projection, though, is that the 10-year yield moves higher to reflect more strength and resilience than the consensus now expects. If the 10-year yield finishes 2019 at 3.40%, as we expect, that could leave room for two rate hikes, maybe three.

For the stock market, we expect a soaring bull market, with the S&P 500 reaching the 3100 we projected for 2018 a year ago. Yes, we know that sounds bold, but our Capitalized Profits Model is screaming BUY. The model takes the government's measure of profits from the GDP reports divided by interest rates to measure fair value for stocks. Our traditional measure, using a current 10-year Treasury yield of about 2.75% suggests the S&P 500 is still massively undervalued. But if we use our forecast of 3.40% for the 10-year yield, the model says fair value for the S&P 500 is 3100. And that leaves room for equities to go even higher if, as we think, profits move higher next year, as well. The model needs a 10-year yield of about 4.35% to conclude that the S&P 500 is already at fair value, with current profits. The bottom line is that we're calling for the S&P 500 to finish at 3,100 or higher next year, which would represent a nearly 25% gain from Friday's close. The Dow Jones Industrial Average should end 2019 at 28,750. Yes, this is likely to be one of the most optimistic forecasts you see, if not the most optimistic one of all. But, in the end, we do best by our readers when we tell them exactly what we think is going to happen, without altering our projections so we can run with the safety of the herd. Grit your teeth if you have to; those who stay invested in the year ahead should earn substantial rewards.

Brian S. Wesbury, Chief Economist & Robert Stein, Deputy Chief Economist, First Trust Advisors, L.P., First Trust Monday Morning Outlook, December 31,2018, https://www.ftportfolios.com/Commentary/EconomicResearch/2018/12/31/dow-28750,-sp-500-3100

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On a Personal Note

Alex came home for the holidays, his first visit as a married man. He and Claire looked great. Technically newlyweds, they already had the air of an old married couple. Claire was on winter break from her graduate studies at NYU. She'll finish up in May and begin her career in social work. Alex took a week of vacation and was able to "work" remotely for another, mostly studying for his upcoming CPA exam. They took a circuitous route in getting here. Brother Collin, you might remember, was to graduate early from the University of Central Florida, so big bro and bride flew from New York to Orlando to meet us for the occasion. A "time management issue" delayed that plan. Collin will don his cap and gown in May, with a good lesson learned.

A robust work schedule gave number two son a much shorter visit. Collin's recent promotion came with a sporty new title, nice salary, sweet office, and much more responsibility. We got to have him for a week, which was about enough ;) Kidding aside, he's doing well. He's recovered from the early-graduation-that-was-not-to-be and now has a lot more time to plan for his next chapter in the upcoming months.

Christmas was crazy this year. It's always about the kids, and the young-ins' were plentiful. First get together was at Annie's house. There is no argument, she is the best mother-in-law in the universe. And she can throw a party. The customary meal is meatball grinders (I think she lived in New Jersey once), and afterwards we all exchange mostly gag gifts. This year, she added a new event. We all know that Annie's got connections but we were shocked to learn she's got an in with St. Nick himself. She had a pile of letters from Santa Claus addressed to all of her great grand nieces and nephews at the party. These letters were read to said young-in by the respective parent. Third up was a letter to Ellie, the 18 month old daughter of Sarah whom I wrote about last year. Sarah is a single-mom. Ellie's father has no involvement, by design. Though the situation is not traditional, there is not a sweeter, more loved little girl anywhere. That said, Sarah has been dating Derrick for about 9 months. This guy is the salt of the Earth. A country boy from Jay, FL, combat Air Force veteran, and father of two daughters of his own from a previous marriage. We all had fingers crossed that this would turn into something more. Well here's Ellie's letter from Santa, "Since I met you at one, I've watched you grow…Now we're celebrating our first Christmas together, ho, ho, ho! I'm sure you've asked Santa for so many things, as we all listen to the jingle bells ring…But one thing I want you to have, is someone that one day you can call dad. So ask your mom now, but ask her with ease…Mom I kind of like Dee Dee, will you marry him please?" There was not a dry eye in the house (dang, I'm crying again!)

Kathleen is the baby in her family. It's been our Christmas Eve tradition to have Annie spend the night, so she can get up with our kids (her youngest grandchildren) and watch them open presents. We always watch a movie, and it's not always seasonal. More often than not, it's a real stinker…usually selected by me (I can't be good at everything ;) . This year, Collin got the honors and as we scanned the selections on Amazon Prime, he came across one that a friend from school told him was solid. All I can say is, like father, like son. The Florida Project started out bad, and got worse. Nothing says Christmas like a movie about a profane, tattoo-covered prostitute living in a cheap motel in the hood in south Florida, from the eyes of her funny, cynical, street-smart, little daughter. Puts a new twist in Ho, Ho, Ho! Thanks Collin, for taking the heat off of me. Collin Facetimed his friend right after the movie who defended his reputation saying, "I didn't say it was a Christmas movie!"

Our boys are grown and gone but I'm honored to be a part in another young man's life. Michael is my Take Stock in Children (TSIC) mentee. He's a wonderful kid and will graduate from Gulf Breeze High School this May to attend the University of West Florida with his TSIC scholarship. Of course, I share lots stories of motorcycling, so, after he completed his safety training at a local motorcycle shop, I took him out to the woods for his first dirt bike ride. Needless to say, he's hooked! Those looking for a worthwhile volunteer effort should check out www.takestockinchildren.org . It is life-changing for all involved.
As always, I hope you're enjoying each day as it comes.

Warmest regards, Jon

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