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Morning Tack - "Disruptive Technologies"

"ARK believes that it is discounting the early stages of a deflationary boom, the likes of which has not been seen since the turn of the nineteenth century."

. . . Catherine Wood, CIO and CEO, ARK Investment Management

I met Catherine Wood when she was a portfolio manager working at AllianceBernstein. She was, and is, a thematic investor, much like the approach I use. I can't remember if it was Thursday or Friday, but one of those days she would hold court at a five-hour brainstorming meeting with her team. I actually sat in on some of those meetings and at one of them I recall discussing the intangible capital theme, which suggests valuations should be higher than the historical norm. To repeat, intangible capital, or intangible assets, are assets like Facebook's 2.2 billion imbedded users, which is certainly a valuable asset, yet it cannot be placed on Facebook's balance sheet. By definition, intangible assets should carry higher valuations than the historic norm. They also tend to be "disruptive technologies," another theme from Cathie. Cathie goes on to note:

> While forecasters may argue that the flattening yield curve is a harbinger of recession and confirmation that the Fed has overstayed its welcome on the side of monetary policy, ARK believes that it is discounting the early stages of a deflationary boom, the likes of which has not been seen since the turn of the nineteenth century. During the next few years, particularly if trade conflicts are resolved with lower tariffs globally and more intellectual property protection in China, ARK's stance is that real growth and profits around the world will surprise on the high side of expectations as inflation drops to surprisingly low levels. Led by the U.S., short rates should continue to rise this year in response to strong and accelerating real growth, while long rates are tamed by continued surprises on the low side of inflation expectations. This explanation of the flattening yield curve seemingly suggests that "this time is different," but this time is not different in the context of technology-enabled disruptive innovation. During the 50 years ended 1929, the last time that three or more general purpose technology platforms were evolving simultaneously, the yield curve was inverted more than half of the time. The disruptive innovation of that time – the internal combustion engine, telephone, and electricity – stimulated rapid growth at low rates of inflation. Through booms and busts in an era without the Federal Reserve and with minimal governmental intervention. U.S. real GDP growth averaged 3.7% and inflation 1.1%, while short rates averaged roughly 4.8% and long rates 3.8%. The yield curve inversions were steepest during periods of rapid growth.

U.S. Markets	Close	Net	1 Day % Chg	YTD %
Dow Jones	24370.10	162.94	0.67%	4.47
Dow Jones Transports	4824.37	47.08	0.99%	4.76
Dow Jones Utilities	705.47	2.53	0.36%	-1.05
S&P 500	2635.96	19.86	0.76%	5.15
NASDAQ	7084.47	49.77	0.71%	6.77
Russell 2000 (Smallcaps)	1467.25	12.55	0.86%	8.80
BKX (Banking)	95.86	0.96	1.02%	11.74
BTK (Biotech)	4844.60	48.77	1.02%	14.78
XOI (Oil Index)	1258.50	11.88	0.95%	8.58
SOXX (Semiconductor)	1200.76	13.57	1.14%	3.95

Key Commodity Prices	Last	Net	
Crude Oil WTI (NYM $/bbl) Continuous	52.740	0.65	
Gold (NYM $/ozt) Continuous	1284.400	-7.80	
Silver (NYM $/ozt) Continuous	15.485	-0.05	
United States Dollar Index	96.030	-0.03	
Market Valuation	**2017**	**2018E**	**2019E**
Consensus S&P 500 EPS	$132	$161	$171
P/E	20.0	16.4	15.4
Treasury Yields	**90D**	**10 Yr**	**30 Yr**
	2.40	2.74	3.07
Source: Factset Data as of:	1/18/2019		

And yesterday Cathie's words, "During the next few years, particularly if trade conflicts are resolved with lower tariffs globally and more intellectual property protection in China, ARK's stance is that real growth and profits around the world will surprise on the high side of expectations as inflation drops to surprising low levels," played in spades as rumors surfaced that the Chinese trade talks were going well. The result lifted the senior index by more than 200 points before settling in at up 163 points. Similarly, the S&P 500 (SPX/2635.96) rallied some 20 points, but still did not break out above the overhead resistance zone we have targeted since the selling climax low of December 24, 2018. Thus, today is session 17 in the upside "buying stampede," which tend to last 17 – 25 sessions with only one- to three-session pauses and/or pullbacks before they exhaust themselves. It just seems to be the rhythm of the thing that it takes that long to get everyone bullish enough and buy just in time to make a trading top. I think this rally has exhausted itself on the upside on a short-term trading basis and would fade the current rally on a trading basis. Yet longer-term, I believe we remain in a secular bull market with years left to run! As the astute Lowry's Organization writes:

> The market rebounded from Wednesday's lackluster rally effort with a stronger advance today. The S&P 500 led the way with a 0.76% gain vs. a rise of 0.67% for the DJIA. Buying showed improvement as Up Volume was 73% of total Up/Down Volume, the highest Up Volume since Jan. 9th. NY Comp. Volume also rose to 3.7 billion shares, 5% above Wednesday's level. The market's ability to rally despite overbought readings suggests underlying strength and that any near-term pullback should be modest.

Obviously, we agree, yet we still do not think the SPX will surmount its 2600 – 2650 overhead resistance zone on this rally. By my work, there is just not enough "internal energy" to support such a move. This morning the S&P 500 preopening futures are better by 7 points as I write at 5:00 a.m., but today is expiration for January options. U.S. markets are closed on Monday for the Martin Luther King Jr. holiday. Ergo, there could be some weird stuff occurring late in the session as traders pursue their individual agendas. Will those that try to mark up stuff for an expiry squeeze absorb traders liquidating for the holiday weekend? Will someone leak/plant a story to impact the markets?

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