BALDINI
INVESTMENT STRATEGIES

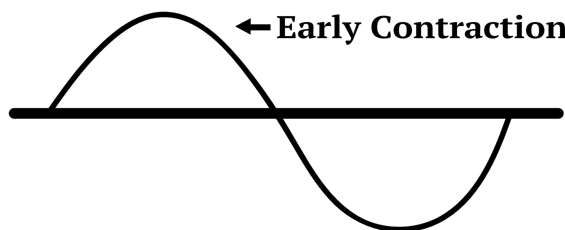
August 2019

Month in Review

The S&P 500 Index hit a fresh high at 3027 on July 26 but closed the month below 3000. Fed Chair Jerome Powell rocked the financial markets when he said the Fed's first rate cut since the financial crisis was a "mid-cycle adjustment" and not the beginning of a series of rate cuts as the market expected. It's time to check our indicators to see how the Fed's mixed messaging has affected them. I have also provided a brief summary of my thoughts on the market going forward.

I. CREDIT CYCLE

PHASE III: EARLY CONTRACTION



The credit market continues to diverge from the stock market in classic Phase III action. Financial conditions remain tight and recession risks are rising. Economic growth has slowed but remains positive and corporate profits are still increasing (with the exception of energy and materials). Stock performance is mixed but we continue to favor the stock market over the credit market.

II. RISK LEVEL INDICATORS

US STOCKS: GUARDED

The Risk Level for US Stocks has deteriorated but remains **GUARDED**. Our short-term Swing Indicators are negative, and the weakness in the credit markets keeps us cautious. "Black swans", defined as unexpected and unknowable events with potentially severe consequences, tend to multiply in this phase of the cycle. By keeping some cash on the sidelines, you will be ready to take advantage of any fear-based selling should it occur.

INTERNATIONAL STOCKS: HIGH

The Risk Level for International Stocks rose to **HIGH** in July and should be avoided until the risk picture improves.

US HIGH QUALITY FIXED INCOME: LOW

The Risk Level for US Fixed Income Quality dropped back down to **LOW** as bond investors sent a strong message to the Fed about the fragile state of the economy and the need for further easing. In the short term, bonds are vulnerable to profit-taking, but in the long-term the outlook is positive.

III. LOOKING AHEAD

Is President Trump short the market? The question is tongue-in-cheek but the timing of Trump's tariff tweets is remarkably consistent with market peaks. The first tariffs were announced in January 2018, as the stock market was making new all-time highs, and triggered a 10% decline in the S&P 500. The index climbed back to a make a new high in September 2018, when Trump slapped 10% tariffs on an additional $200 billion in goods, ultimately resulting in a decline of almost 20%. In May 2019, just as the major stock averages were about to break out to new all-time highs, Trump raised tariffs on some Chinese goods to 25%, halting the advance and precipitating a 6.6% drop in the index over the next few weeks. Some have suggested this is Trump's way of putting pressure on the Federal Reserve to lower interest rates to offset the tariffs. It has worked until now, but the markets seem to fear he may have grabbed a tiger by the tail.

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