BALDINI
INVESTMENT STRATEGIES

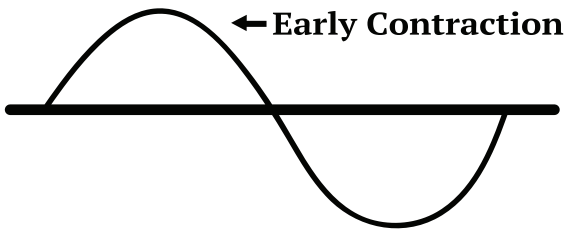
October 2019

Month in Review

The S&P 500 Index gained 1.7% in September recouping nearly all of August's loss. The first half of the month was filled with optimism on trade as China refrained from retaliating against the most recent set of tariff increases by the Trump administration, and the two countries announced a high-level trade meeting to be held on October 10-11. The good news ended there, however. The final days of the month witnessed a much-anticipated Fed rate cut but with the most dissents in nearly five years; crisis- era chaos in the short-term borrowing market between banks; and the launch of an impeachment investigation into Donald Trump's alleged abuse of power for political gain. It's time to check our indicators to see how these rapid-fire events have 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 markets were showing encouraging signs of improvement before worsening economic data and the release of the transcript of Trump's July phone call with Ukrainian President Zelensky drove investors out of risky assets and back into the relative safety of US Treasury bonds and gold. Credit markets continue to be pressured by tight financial conditions, widening credit spreads, and rising recession risks. Stock market performance in this phase of the cycle is mixed, with the stronger sectors masking the worsening performance of the weaker ones. It is important to be selective, but as long as the economy is growing, corporate profits are rising, and interest rates are falling, we continue to favor the stock market over the credit market.

II. RISK LEVEL INDICATORS

LOW *GUARDED* *ELEVATED* *HIGH* *SEVERE*

US STOCKS: ELEVATED

The Risk Level for U.S. Stocks remains **ELEVATED** in response to rising policy uncertainty, worsening economic data, and a formal impeachment inquiry of the President of the United States. In an about-face from last month, our short-term Swing Indicators have turned down even as the longer-term indicators have turned up, suggesting that the underlying fundamentals are improving even as investor pessimism has deepened.

INTERNATIONAL STOCKS: HIGH

The Risk Level for International Stocks remains **HIGH** and it is best to look elsewhere until the risk level improves.

US HIGH QUALITY FIXED INCOME: GUARDED

The Risk Level for **US Fixed Income Quality** remains **GUARDED** as the recent outperformance of bonds is offset by their extremely overbought technical condition. In the short-term, bonds are vulnerable to profit-taking but the long-term outlook is positive.

III. LOOKING AHEAD

We mused last month that if the political worries plaguing investors were to be resolved, the markets would likely pop to the upside. Instead, the political worries have deepened, the economy is showing signs of stalling, and earnings are expected to be negative for the third quarter in a row. Yet the S&P 500 doesn't seem to care as it trades in a tight range between 2850 and 3000. What gives? "This avalanche of bad news is now so powerful… it has become good news," claims finance blog Zero Hedge. "Things have gotten so bad the policymakers will soon panic and flood the markets with stimulus," says BoA's CIO Michael Hartnett, "including rate cuts from the Fed and a deal with China on trade." October contains a number of catalysts that could set the course for the rest of the year. As they say in the movies, "Fasten your seatbelts, it's going to be a bumpy ride."

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