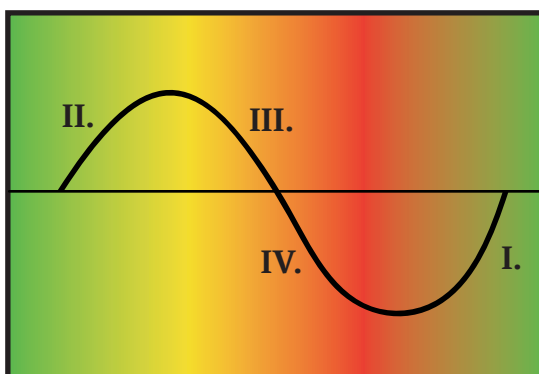


Month in Review

The market “melt-up” showed no signs of stopping in December as the S&P 500 Index gained 2.86% with hardly a down day. Santa Claus came early when the United States and China agreed to a “phase one” trade deal that averted the 15% tariffs scheduled to go into effect on nearly \$160 billion worth of Chinese goods. It’s time to check our indicators to see how the powerful year-end trade-war relief rally has affected them. I have also provided a brief summary of my thoughts on the market going forward.

I. CREDIT CYCLE

PHASE II: EXPANSION



Credit markets have rallied as financial conditions have eased, credit spreads have narrowed, and recession risks have receded. Even the spreads on the riskiest credits such as CCC-rated bonds and double-B CLOs (securitized corporate loans) have improved. The Fed has expanded its balance sheet at an annualized rate of 40% over the last three months--faster than during QE1, QE2 or QE3. With the money supply growing faster than the economy, the excess liquidity is flowing into the stock market as investors throw caution to the wind and party like it’s 1999.

II. RISK LEVEL INDICATORS



US STOCKS: GUARDED

As Yogi Berra said, “It’s like déjà vu all over again.” The Fed’s massive liquidity injection is reminiscent of Y2K and the “dot.com” bubble days, and has pushed the Risk Level for **U.S. Stocks** up to **GUARDED**. The equity markets are overbought so caution is in order, but the Swing Indicators are positive so any pullback will likely be short and shallow and can be taken as an opportunity to “buy the dip”

INTERNATIONAL STOCKS: LOW

The Risk Level for **International Stocks** is **LOW** as the “phase-one” trade deal with China buoys optimism around the world. In a positive sign for global growth, export-dependent emerging markets are back on a buy signal for the first time in over three years. The lessening of trade tensions and aggressive Fed easing have let some air out of the US dollar as well, making foreign markets more attractive to US investors.

US HIGH QUALITY FIXED INCOME: GUARDED

The Risk Level for **US Fixed Income Quality** is **GUARDED** and the relative strength ranking continues to decline. Investors have rotated from bonds to stocks as recession fears have collapsed and the stock market has raced ahead. If the economy improves as much as the stock market seems to say it will, bonds could see further downside as inflation picks up and interest rates rise.

III. LOOKING AHEAD

*Buy high and let it fly.
Jack Hough, Barron’s*

Looking back at 2019, it was a year in three acts, says Morgan Stanley. Act I: a powerful rally from depressed levels as the Fed made a dramatic policy reversal; Act II: a volatile period of no gains for five months as trade progress stalled and global data was weak; Act III: a blast-off to new highs driven by a truce in the trade war and \$400 billion in liquidity injections by the Fed. Jim Bianco at Bianco Research says we’ve seen this movie before. In late 1999 the Fed pumped in billions of dollars to ward off impending disruptions from the Y2K computer glitch and in the process inflated the “dot.com” bubble. The huge shot of cash was like rocket fuel to the Nasdaq which went on a tear before crashing when the Fed’s special lending facility closed in April 2000. The big question today is what happens when the Fed ends support this time? Have we learned from history or are we doomed to repeat it?

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