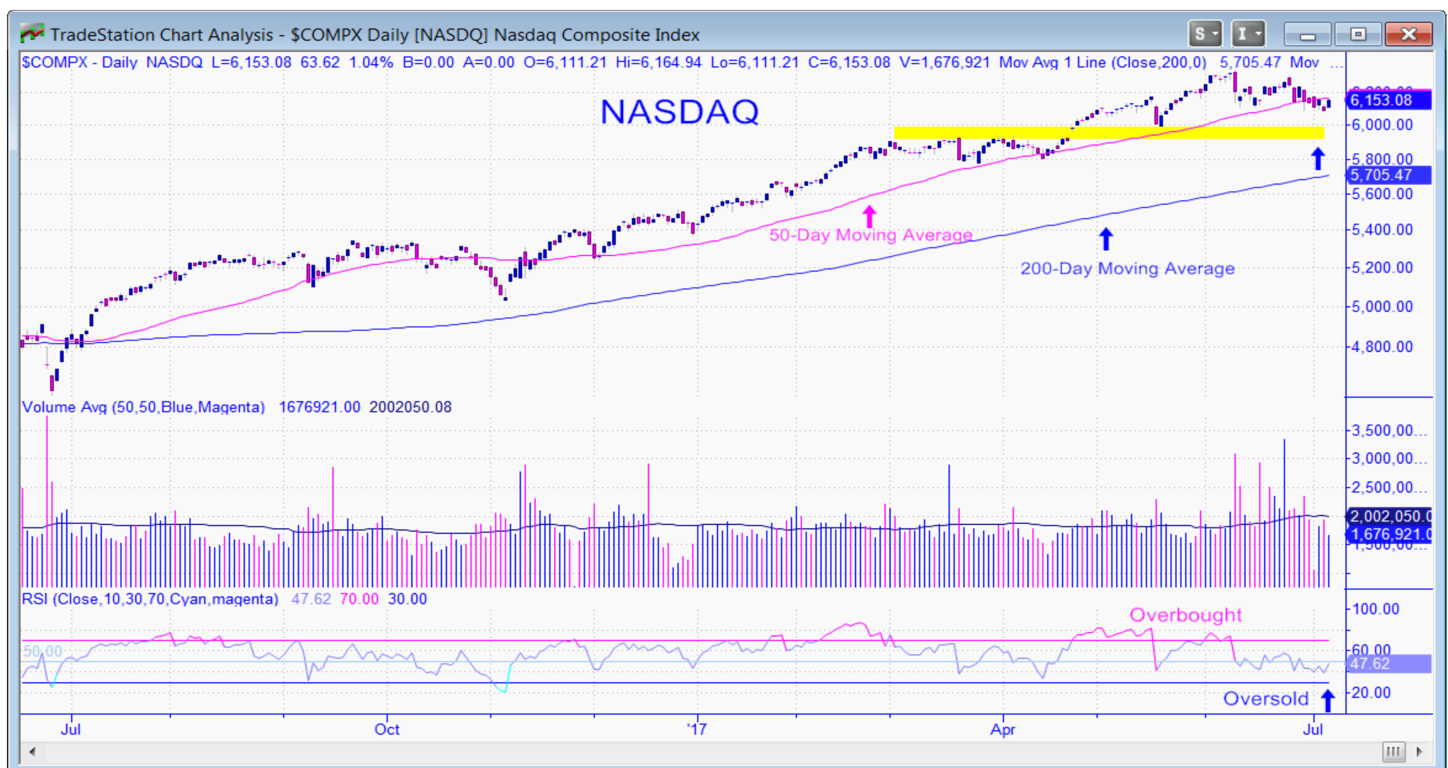
Titan Capital Management, LLC
Global Market Letter

July 7, 2017 **Abe Askil, CFP®**

GLOBAL STOCKS DOWN IN JUNE

While the S&P 500 rose slightly in June, most stock markets around the world were down. The Fed raised short-term rates in June, which I cover on page 2. The Fed is also talking about unwinding their balance sheet which means that they are going to start selling off the $4 trillion in assets (bonds) that they purchased since late 2008. The purpose of QE was to create a "wealth effect", according to former Fed Chairman Ben Bernanke, by inflating asset prices. One would think that unwinding QE would create the opposite effect. Hence, when the Fed starts reducing its balance sheet it will most likely cause asset prices to fall. Something else that was interesting in the Fed Minutes is the following statement "In the assessment of a few participants, equity prices were high when judged against standard valuation measures." The Fed has a horrible record of identifying asset bubbles, so when they admit that stock prices are overvalued it's worth noting. Longer-term bond yields had been declining despite the Fed raising short-term rates, but this seems to have changed over the past two weeks as the 10-year treasury has risen from a yield of 2.1% to 2.4%. Yields have also risen recently in Europe and Japan which is making some investors nervous. We have seen yields rise in the short-term several times over the past few years only to come back down. We'll see if this time is different and if rates continue to rise. If rising yields are not accompanied by strong economic and earnings growth, it will be negative for assets such as stocks and real estate.

The technology sector has been the strongest sector year-to-date and this is still the case despite a -4.7% decline in June. The tech heavy NASDAQ Composite is down approximately -2.7% from its all-time high. The NASDAQ fell below its 50-day moving average and is attempting to move back above it as shown in the chart below. There is support for the NASDAQ in the 5,900 to 6,000 area which is highlighted in yellow. If these levels are broken, then the next support level will be in the 5,700 to 5,800 area which is where the 200-day moving average (blue line) resides. A drop below this level could be negative for the overall market. The NASDAQ was near oversold levels and this may be one of the reasons why it rose over 1% today. There may be a bit of sector rotation happening where some investors are selling tech stocks and moving into beaten down sectors such as the financials. Time will tell if the pullback is temporary and whether or not investors step in to buy the dip, or if this is the beginning of a bigger move lower for tech stocks.



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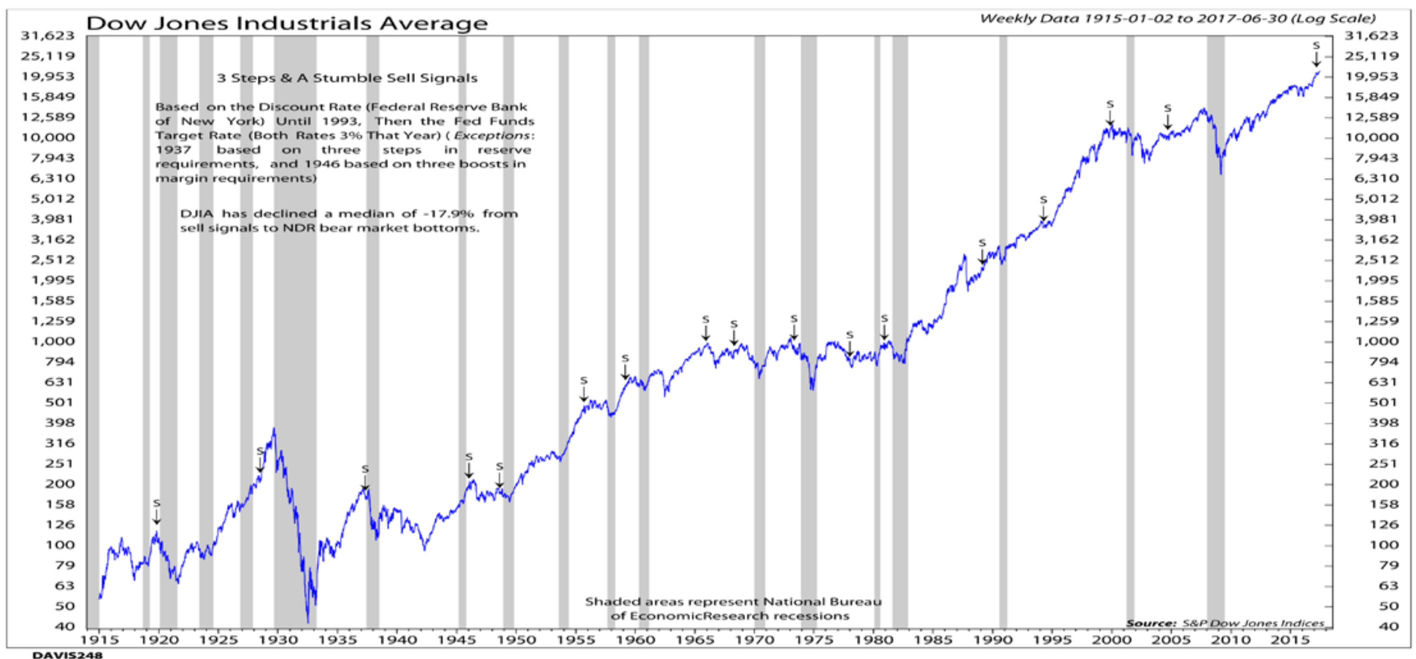
3 STEPS AND A STUMBLE

Monetary policy has historically had a big impact on the financial markets and the economy which is why we include monetary indicators in our trend models Alpha and Omega. Whenever the central banks, like the Fed, want to provide a boost to the economy they will lower short-term interest rates and when the want to slow down the economy they will raise rates. The Fed Funds Rate is the interest rate in which banks lend to each other and the Discount Rate is the rate in which the Fed lends to banks. The Fed has raised short-term rates four times since December 2015 and taken the Fed Funds Rate from .25% to 1.25% and the Discount Rate from 0.75% to 1.75%. Historically, whenever the Fed has raised rates three times or more, referred to as 3 Steps & A Tumble by the legendary Edson Gould, it has been bearish for stocks and the economy. Since 1915, there have been 17 "Three Steps & A Stumble" sell signals and the market declined 15 out of the 17 times at a median rate of -17.9% as shown in the chart below. The shaded areas on the chart represent recessions and there were only 2 signals out of the 17 that did not lead to a recession. The Fed raised rates 6 times in 1999 and 2000 just before the stock market topped and the economy went into a recession. They raised rates 17 times from 2004 to 2006 before the real estate and stock markets topped and the U.S. experienced the worst recession since the 1930's Depression. It is unlikely that the markets can withstand many more rate hikes given the high valuations in assets such as stocks and weak economic growth. The Fed is most likely raising rates so that they have room to lower them during an economic or financial crisis. Central banks around the world have lowered interest rates to zero (or negative) and printed over $12 trillion dollars since 2009. The easy money policies are the primary reason that global stock, bond and real estate markets have risen since then. A reversal of these policies will most likely be quite negative for the global financial markets.



THE BOTTOM LINE

Our trend models Alpha and Omega are both positive, but we continue to see some deterioration in our breadth, monetary and sentiment indicators. The tech sector which has led the market this year underperformed in June. This may be a short-term aberration, but if the underperformance continues it will be a headwind for the general market. Monetary tightening and geo-political issues such as North Korea are a concern. Therefore, we are standing closer to the exit doors.

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