PRIVATE WEALTH ADVISORY

INVESTMENT RESEARCH THAT CONVERTS

2018 Review and 2019 Forecast

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As forecast in January '18, my predictions for 2018 were the following:

1) Commodities would dramatically outperform stocks in 2018.

2) US Treasuries would drop, then rally, as Central Banks were forced to tighten aggressively mid-year to choke off inflation. By year-end the yield on the 10-Year Treasury would likely be flat. Bonds were to be traded, not bought long-term last year.

3) Value would dramatically outperform growth.

4) The $USD would end 2018 in the mid-'80s.

So how did these do?

#1 was flat out wrong, though not for reasons one would expect. Neither commodities nor stocks did well in 2018, falling -12% and -6% respectively. Moreover, the only reason stocks ended the year higher than commodities was due to massive intervention that occurred on the last few trading sessions of the year.

So that forecast was just plain wrong.

#2 on the other hand, was both right *and* wrong.

Treasuries DID drop and then rally, but the drop lasted well into November, not mid-year. Because of this, by the time the rally hit, it was too large for the yield on the 10-Year to end up flat.

So while my forecast of the moves was correct, the end result was wrong.

#3 was also flat out wrong. Growth stocks (black line) outperformed Value (blue line) though both ended the year DOWN.

And finally #4 was ALSO wrong, with the $USD rallying strongly into the year-end, finishing in the mid-90s.

So, to review, I was at best right on 0.5 out of 4 predictions. That is nothing to be proud of and certainly nowhere near the success rate I experienced in 2017 or 2016 in my forecasts for those years.

So what happened?

The Fed and Jerome Powell happened.

As I noted throughout 2018, the new Fed Chair was unlike any Fed Chair of the last 40 years in that he was 100% devoted to the real economy and couldn't care less where stocks traded (at least this appeared to be the case up until last week as we will discuss later this issue).

I knew Powell would be different from Greenspan, Bernanke and Yellen as a result of his private sector experience and his attitude towards the economy. However, I completely underestimated how different he would be.

Specifically, I underestimated the amount of financial market turmoil Powell would be able to stomach before he "took a knee" and backed off on his hawkishness. I had thought that once the Emerging Market space began melting down in the first half of 2018, Jerome Powell would grow concerned about contagion to the US and would slow the pace of the Fed's QT program.

This, in turn, would have resulted in the $USD dropping, and reflation trades along with Emerging Markets exploding higher in the second half of 2018.

That didn't happen because the Fed DIDN'T react to the carnage at all. Instead, Jerome Powell pushed even **MORE aggressively** for rate hikes and a **faster pace** of QT starting in June 2018.

And that marked where things went off the rails in terms of my forecasts. Up until Powell's June 2018 testimony to Congress, all but one of my forecasts had been EXTREMELY accurate.

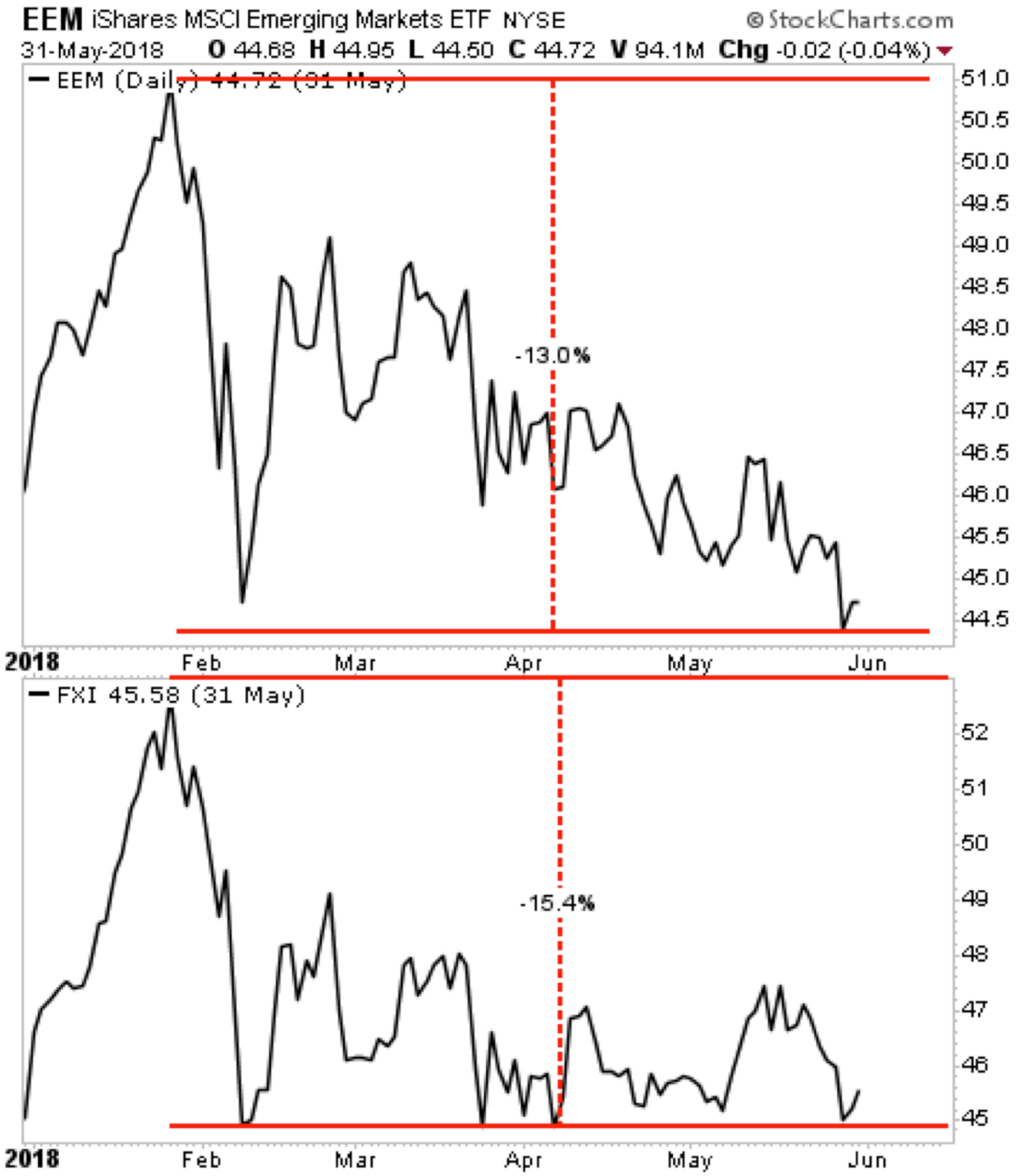
Commodities were crushing stocks:

Bonds were falling, as yields rose.

The one incorrect forecast was that Growth was outperforming Value:

But the $USD was collapsing and moving into the '80s.

By this time the Emerging Market space, particularly China, were in a meltdown mode, having fallen 13%-15% from their 2018 highs.



Moreover, it's not as though this was confined to the EM space. Industrial bellwethers such as Caterpillar and 3M had both begun to collapse as well signaling that global growth was in a freefall.

The Fed didn't heed any of those warnings. Instead, the Fed increased its QT program to $30 billion per month in April, the $USD ignited and the reflation trade was killed in a matter of weeks.

Seeing this, I began to adjust my forecast in the summer of 2018 towards a deflationary collapse hitting stocks. Specifically, I warned that unless the Fed changed course, the US markets would collapse.

I also began to adjust out portfolio, closing out reflationary positions and moving aggressively into cash, Treasuries and Shorts.

As a result of this, our portfolio ended up having a solid year despite my initial forecasts proving incorrect.

As I've stated previously, normally when it comes to tracking our performance, the model I use for tracking our success is as follows:

1) Equal position sizing in all core positions (everything except Hedges which I **historically have emphasized** should be kept smaller).

2) Focusing on closed positions due to the fact they are the only positions I can 100% guarantee subscribers participated in.

However, once I realized the deflationary environment we were facing in mid-2018, I altered #1, and stopped emphasizing that Hedges/ Shorts should be kept smaller. In a bear market,

Shorts can be core positions. And that was the case for us starting in July 2018.

As a result of this, our portfolio finished 2018 UP 6%, while the S&P 500 finished the year DOWN 6%, for an outperformance of 12%.

We managed to accomplish this due to having an EXTREMELY high success rate with our trades: in 2018, we closed 80 positions of which 61 were winners, or a **success rate of 76%.**

I've posted all of our closed trades for the year on the ***Private Wealth Advisory*** subscriber website. There is also a link to a page detailing all of our closed trades running back to 2015.

So if 2018 was the year the financial system shifted from reflation to deflation, 2019 will be the year that we get an outright bear market with a global recession thrown into boot.

Globally it is now clear that the economy has turned for the worse.

In the last week alone the following have been announced…

1) South Korean exports, a critical measure for global growth, recorded a -1.2% drop year over year for December.

2) China's manufacturing PMI fell into outright contraction below 50. Given how massaged this metric is, reality is likely far worse.

3) German Industrial Production fell 1.9% month over month and 4.6% year over year in November: the biggest drop since 2009. Germany is officially in a recession.

4) Apple, Samsung, LG, Fed Ex, Delta, Skyworks, Macy's, Kohl's, and American Airlines all lowered forward guidance for 2019.

5) US manufacturing ISM dropped sharply from 59% to 54% (not yet in contraction mode, but rapidly approaching it).

Taken together, these points indicate that the global economy is slowing. That alone is problematic for risk assets. However, combined with the sharp drop in Central Bank liquidity the door is now open to a major, and prolonged bear market.

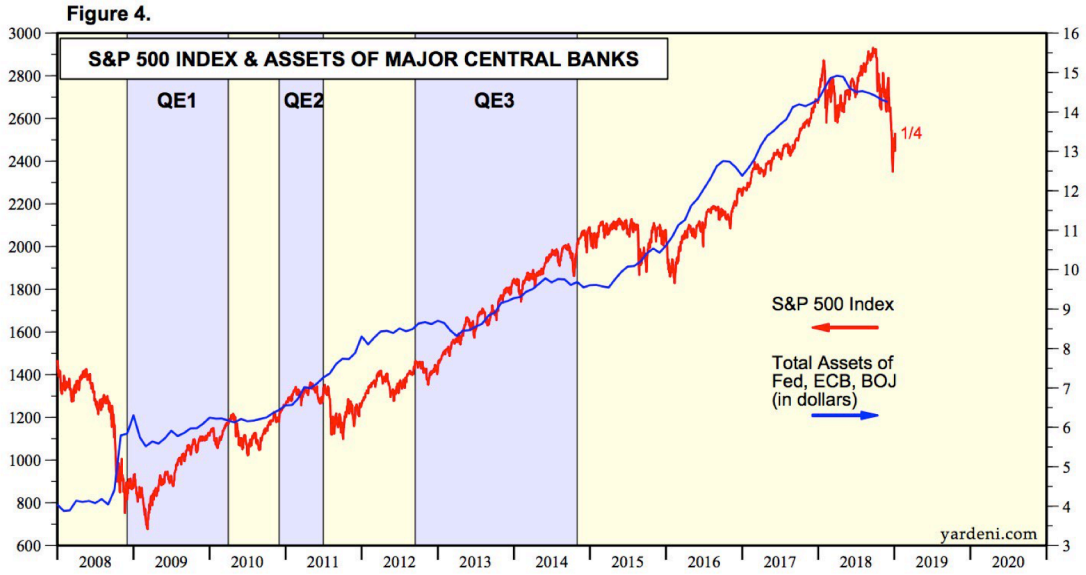
Let me explain.

Historically stocks have traded based on two things: economic activity and liquidity. Usually it's a mix of both, but in the aftermath of the 2008 Crisis, Central Banks attempted to overcome the

weakness of the economic recovery with TREMENDOUS amounts of liquidity.

They also created a bubble in sovereign bonds via rate cuts and Quantitative Easing (QE) programs. And because the yields on these bonds represent the "risk free" rate of return for the financial system, doing this moved ALL risk assets into bubble-territory, hence my coining the term ***The Everything Bubble***.

As a result of all of this, the historic relationship between economic activity and stocks became severed as the latter began tracking Central Bank liquidity as the below chart reveals.



Note: QE1 (11/25/08) = Fed starts buying $1.24tn in mortgage securities. QE1 expanded (3/16/2009) = Fed starts buying $300bn in Treasuries. QE2 (11/3/10) = Fed starts buying $600bn in Treasuries. QE3 (9/13/12) = Fed starts buying $40bn/month in mortgage securities (open ended). QE3 expanded (12/12/12) = Fed starts buying $45bn/month in Treasuries.
Source: Federal Reserve Board, Standard & Poor's and Haver Analytics.

In this environment, economic weakness was viewed as bullish for stocks because it would induce Central Banks to provide more liquidity. This resulted in the phrase "bad news is good news" being applied to stocks for much of 2008-2016.

Not anymore.

As of December 2018, both the US Federal Reserve (the Fed) and the European Central Bank (ECB) are actively withdrawing liquidity from the financial system. To make matters worse from a liquidity perspective, the Bank of England (BoE) is no longer engaging in QE while the Bank of Japan (BoJ) is tapering its QE program.

Put simply, on a net basis, Central Banks as of December 2018 are withdrawing liquidity from the system for the first time since the 2008 crisis.

So stocks are now facing the prospect of a global recession at the same time that Central Banks are withdrawing their liquidity life support.

There is simply NO WAY that stocks enter a new bull market in this atmosphere. Again, on the monthly chart, the picture is clear, the credit cycle has peaked and we are moving into a bear market/ crisis.

Does this mean we will not have sharp bounces like that of the last week? Not at all, indeed, sharp bounces are a HALLMARK of bear markets as they are meant to draw in investors only to then roll over. **But unless the S&P 500 can clear 2,750 the bull market is OVER**.

As a brief aside, I want to take a moment to address what triggered this recent bounce in risk assets. Last Friday, Fed Chair Jerome Powell did a complete 180 and issued one of the most dovish statements in Fed history. Amongst other things Powell suggested the Fed would be open to pausing its rate hike schedule as well as potentially changing the pace of its Balance Sheet reduction.

Why Powell chose to do this is anyone's guess. It could be that he finally bowed to pressure from the White House. It could be that he finally bothered to look at some charts of the financial system. It could be that the recent spate of economic data was bad enough that he got nervous. No one knows.

What IS clear is that Powell finally hit the "panic" button. But unfortunately for him, it's too little too late. The credit cycle has officially turned. All Powell has done is given it an opportunity to bounce from oversold conditions.

On that note, the TIP: TLT (inflation= up/ deflation= down) ratio bounced off of support, on Powell's comments.

This inflationary impulse is what drove the sharp move higher in Credit, Oil and stocks, but it is now ending. The ratio faces overhead resistance as well as its 23-day exponential moving average. I do not expect to see the ratio break above either.

Similarly, the Junk Bond to Long-Treasury ratio is running into multiple bands of resistance…

... as is the Junk Bond to Investment Grade ratio.

All of the above charts are telling me that the credit market is at a turning point. Credit leads stocks. So while we might get a day or more of upwards action, the system is facing duress once again.

In terms of stocks, I think the top may be in for this bounce.

The S&P 500 looks like it was rejected at resistance.

The picture is even uglier for the Russell 2000.

Some of you are probably wondering how I can be so certain that the bottom is not in. The answer relates to the VIX. The volatility index has remained elevated despite the sharp "risk on" move in asset prices. The system remains jittery.

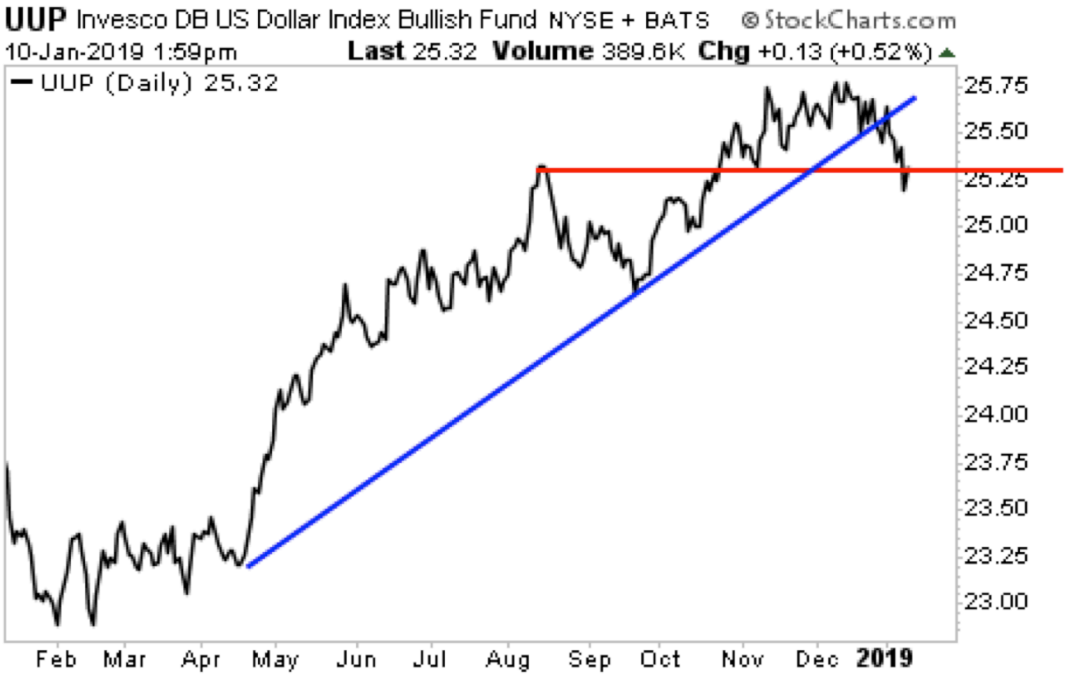
On a monthly basis we're not even close to re-entering the former downtrend. This would be needed if stocks were indeed going to start a run to new all-time highs.

Now, I've seen some arguing that the US is going to sign a trade deal with China, which combined with the Fed's recent dovish turn, should ignite a major "risk on" move.

If that were the case, China's stock market should have rallied harder. It hasn't even taken out the December highs and remains in a confirmed downtrend.

Emerging Markets (EEM) as a whole look better, but they still remains below resistance (blue line).

Indeed, I think that entire move in the EM space was due to the $USD staging a false breakdown based on Powell's verbal interventions. If it was, we should see a strong rally starting soon.



Elsewhere in the markets. Retail has rolled over, after being rejected by resistance.

Action to Take: Short the Retail ETF (XRT)

JP Morgan (JPM) is about to do the same:

Action to Take: Short JP Morgan (JPM)

These items are telling us that the economy is worsening (a consumer spending slowdown is underway) and that the door is open to a crash (JP Morgan's massive derivatives portfolio make it a "canary in the coalmine" for systemic risk).

I believe that this "risk on" move in the financial system will soon be ending. I was obviously a week early here, but given what's coming, those paper losses will soon be large winners.

Bottomline: the global economy is rolling over, Central Banks are tightening, a trade war remains underway, and investors remain extremely complacent.

This is the kind of environment in which crashes hit. I expect we'll get one shortly.

This concludes this week's update for ***Private Wealth Advisory***. I'm watching the markets closely and will issue updates as needed. Barring any new developments you'll next hear from

me next Thursday, January 17th.

In the mean-time, if you are looking for a way to play short-term market moves or to get into day trading for larger, more rapid gains, I also run a weekly options trading service that typically holds positions for just 2-3 weeks at the most, and usually just a few days.

It's called ***The Crisis Trader*** and it uses options to trade highly predictable moves in stocks and ETFs for double-digit gains. **Since inception, this newsletter has returned average annual gains of 41%. We just closed out a 13% gain last week… bringing our current win streak to 10 straight winning trades, 9 out of which were double digit winners.**

Typically a subscription to this service costs $799. But I'd like to invite any of you to join at a discounted rate of $499 (35% off the usual market price).

You can try it for 60 days. If you find it's not what you're looking for, you can email us at support@phoenixcapitalresearch.com and we'll issue a full refund no questions asked.

To take out a 60 day $499 trial subscription to ***The Crisis Trader*** use the link below.

https://www.phoenixcapitalmarketing.com/tctrenewal499.html

Until Thursday

Best Regards,

Graham Summers
Chief Market Strategist
Phoenix Capital Research

OPEN POSITIONS

BONDS PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Change From Last Week	Total Return *
Long Treasury ETF	TLT	6/27/18	$122.11	$120.46	-2%	2%
7-10 Year Treasury ETF	IEF	10/25/18	$100.69	$103.86	-1%	4%

PRECIOUS METALS/ MINERS PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Change From Last Week	Total Return*
Gold		3/17/10	$1,120	$1,287.00	-1%	15%
Silver		3/17/10	$16.23	$15.61	-1%	-4%
First Majestic Silver	AG	5/12/17	$7.43	$6.06	-3%	-18%
Iamgold	IAG	9/28/17	$6.40	$3.70	-3%	-42%
Silver Mining ETF	SIL	10/4/17	$32.51	$26.18	1%	-19%
Silver Mining Juniors ETF	SILJ	10/4/17	$11.83	$8.69	1%	-27%
Gold Mining ETF	GDX	6/6/18	$22.58	$21.00	-2%	-7%
Gold Mining Juniors ETF	GDXJ	6/6/18	$32.99	$30.70	-2%	-7%
Hecla Mining	HCLA	7/23/18	$3.39	$2.79	8%	-18%

Prices as of 1/10/19 at market's close.
***Gains include dividends**

Bear Market Portfolio

Position	Symbol	Buy Date	Buy Price	Current Price	Change From Last Week	Total Return*
Emerging Markets ETF (SHORT)	EEM	12/6/18	$40.64	$40.93	-6%	-1%
Rio Tinto (SHORT)	RIO	12/6/18	$46.38	$50.59	-8%	-9%
Amazon (SHORT)	AMZN	1/3/19	$1,500.28	$1,656.22	-8%	-8%
Alphabet (SHORT)	GOOG	1/3/19	$1,016.06	$1,070.33	-3%	-3%
UltraShort Oil ETF	SCO	1/3/19	$27.63	$21.99	-20%	-20%
Japan ETF (SHORT)	EWJ	1/3/19	$50.73	$53.46	-5%	-5%
UltraShort Russell 2000	TWM	1/3/19	$21.11	$17.81	-14%	-14%
Retail ETF	XRT	1/10/19	$43.60	**NEW**	**SHORT!**	
JP Morgan	JPM	1/10/19	$100.39	**NEW**	**SHORT!**	

CASH/ CURRENCIES PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Change From Last Week	Total Return*
US Dollar ETF	UUP	11/8/18	$25.75	$25.34	-1%	-2%

MACRO TREND PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Change From Last Week	Total Return*
Corsa Coal	CRSXF	12/21/17	$1.20	$0.54	-1%	-55%
Uranium ETF	URA	1/17/18	$14.93	$12.46	5%	-15%

Prices as of 1/10/19 at market's close.
***Gains include dividends**