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Weekly Market Update 5-2-19

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Yesterday's Fed meeting was a bit of a mish mash.

On the one hand, the Fed is now tightening *less*, having reduced its monthly Quantitative Tightening (QT) schedule from $50 billion per month to $15 billion per month.

That means less liquidity leaving the system, which is good for risk assets… but it's not the same thing as easing; it's just tightening at a slower pace.

The Fed *did* cut its Interest Rate on Excess Reserves (IOER) for banks by a mere 5bps, but that was largely to bring the IOER in line with the official Fed Funds Target Rate. Put simply, this was a technical issue to bring the two rates the Fed in line with one another, not an actual legitimate rate cut.

So while this wasn't the extremely dovish Fed meeting the markets had hoped for, it was a step in the right direction if your primary concern is ramping stocks higher. We had something of a rate cut, however small… and QT has been dramatically reduced.

Having said that, actual monetary easing *is* coming… likely within the next six months. The reason is simply… the Fed and the President of the United States, are in the "bubble business."

Let me explain…

If you'll recall, a few weeks back I detailed an article that was written by Dallas Fed President Robert Kaplan. The key quotes were the following:

> ***U.S. nonfinancial corporate debt as a percentage of GDP is now higher than the prior peak reached at the end of 2008…****Nonfinancial corporate bonds outstanding in the U.S.* ***grew from approximately $2.2 trillion in 2008 to approximately $5.7 trillion at year-end 2018****…*
>
> ***An elevated level of corporate debt, along with the high level of U.S. government debt, is likely to mean that the U.S. economy is much more interest rate sensitive than it has been historically.***
>
> Source: The Dallas Fed

I realize this is a bit opaque so let's be very clear here… what Kaplan is saying, in the simplest of terms, is that there is no longer any difference between the US economy and the stock market; **the entire US financial system is now just one gigantic leveraged bet on low interest**

rates.

In this scenario, the Fed can NEVER normalize policy… because doing so would blow up the corporate debt bubble, which in turn would destroy the US economy.

There's a second layer here too…

It is now clear the Fed has no idea how to solve the structural issues in the economy (low growth and declining incomes). As a result of this, the only thing the Fed *can* do is create a bubble in stocks to generate the wealth effect (when people see their stock portfolios are higher, they feel richer and are more likely to spend money even if it means going into debt to do so).

In this scenario, the Fed will ease to force stocks higher, thereby generating some kind of economic growth in the form of consumer spending. That this spending comes as a result of credit, not incomes, is no longer the Fed's concern. The Fed is in the bubble business.

Finally, creating a bubble in stocks also benefits corporate America.

Given that excessive leverage is a BIG problem for US corporations… the Fed can help reduce leverage ratios by ramping stocks higher, thereby increasing each company's equity relative to its debt.

If your market cap is $1 billion and you have $1 billion in debt, you're highly leveraged. But what if your stock moves higher making your market cap $2 billion? Suddenly your leverage levels have been cut in half.

I realize all of this sounds ludicrous… but this is the age we live in.

The Fed is in the bubble business. It can never normalize policy. Yes, it might have the occasional rate hike here or there down the road, but the notion of rates returning to historic norms (5%) or the Fed balance sheet shrinking to its pre-Crisis levels (~$1 trillion) is OVER for good.

THIS is why the Fed was forced to implement its now ridiculed U-turn in policy… it's also why the Fed will soon be easing… and it's why the stock market bubble is going to continue growing, until something breaks in a truly spectacular fashion.

The Fed knows this too, which is why it is already laying the groundwork for the next round of monetary easing.

Consider the following… in the last two months Fed officials have suggested the following policies:

1) Making QE a normal policy, rather than something to be used during emergencies.
2) Implementing Negative Interest Rate Policy (NIRP) during the next economic downturn.
3) Buying corporate bonds via QE.
4) Capping Treasury yields by buying US bonds anytime yields rise above a certain level.

All of these suggestions came at a time when the stock market was having its best first quarter in years and was within 5% of new all-time highs.

Then, on Monday, the Fed floated the following idea:

> ***<u>Federal Reserve officials are considering a new program that would allow banks to exchange Treasurys for reserves, a move aimed at ensuring liquidity during difficult times that also would help the central bank decrease the size of its nearly $4 trillion balance sheet.</u>***
>
> *The so-called standing repo facility is in its early discussion phases. Respected St. Louis Fed economists David Andolfatto and Jane Ihrig have authored two papers on the plan, which they say would ease the regulatory burden for banks that feel pressured into holding ultra-safe assets.*

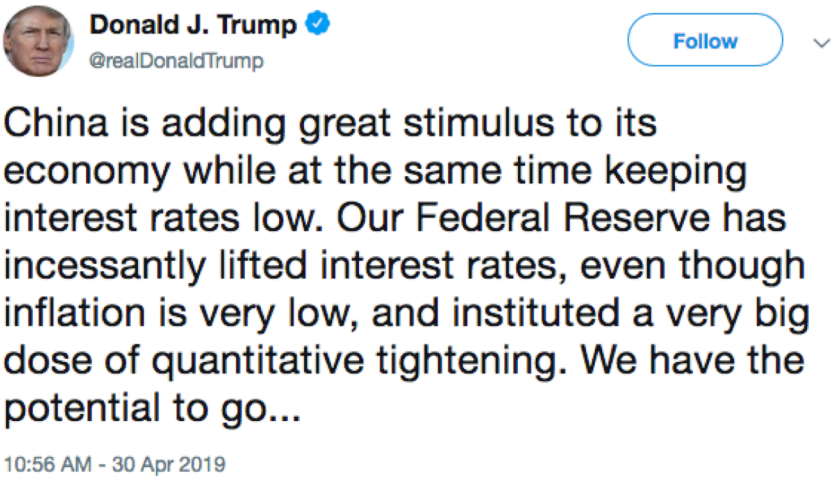
https://www.cnbc.com/2019/04/29/fed-looking-at-a-program-that-could-be-version-of-quantitative-easing.html

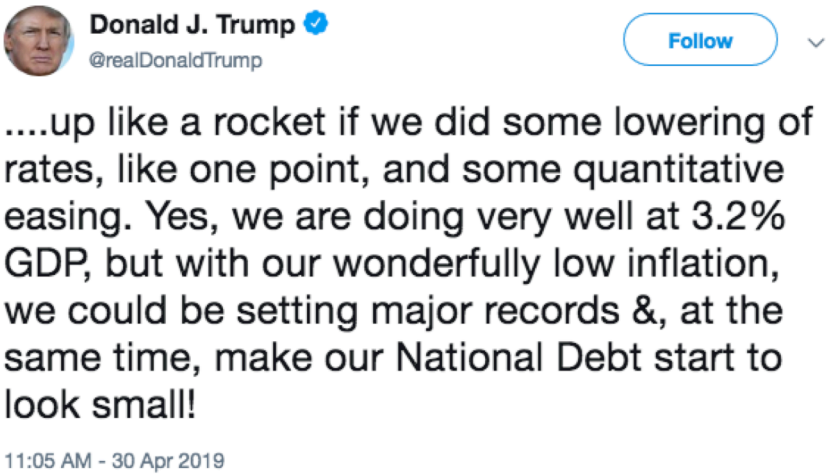
Yes… the Fed suggested it might introduce a type of QE… **at a time when stocks had literally just hit new all-time highs.**

The Fed is not alone in wanting stocks higher. Top Trump administration official Larry Kudlow have been calling for the Fed to cut rates by 0.5% for weeks now…

> ***A top Trump administration official on Friday called on the Federal Reserve to cut its key interest rate by a half-percentage point.***
>
> ***Larry Kudlow, head of the president's National Economic Council, said in an interview with CNBC that the Fed should do more to help the economy by cutting rates****. It signaled last week that it expected to keep rates unchanged for this entire year after raising its benchmark rate four times in 2018 to the current level of 2.25 percent to 2.5 percent.*
>
> *https://www.apnews.com/c1b9066a6edf40fb909b4cb0c0b5278c*
>
> *Slowing inflation may lead the Federal Reserve to cut interest rates, White House economic adviser Larry Kudlow said in a television interview on Monday.*
>
> *"**The Fed is independent, but they have been themselves talking about coming and lowering their inflation target, which might mean a lower interest rate adjustment on their own timetable**," Kudlow said to Fox Business Network.*
>
> https://www.reuters.com/article/us-usa-fed-inflation/slowing-inflation-may-lead-fed-to-cut-interest-rates-kudlow-idUSKCN1S51MW

Moreover, the President has made this one of his favorite themes on Twitter.





The Fed will be easing later this year. It's too early right now, but easing is coming, both in the form of rate cuts and some form of QE.

This is not a matter of what's right… it's a matter of the fact that no Fed official wants to be the person who blows up the financial system… and the entire financial system is just one gigantic leveraged bet on low rates… which require more easing to stay low.

Speaking of which, the yield on the 10-Year US Treasury has broken its uptrend (blue lines), it is now in a clearly defined downtrend (red lines).

The Fed cannot afford a breakout to the upside here.

Which is why I believe stocks will be correcting shortly, thereby driving capital into bonds to force yields down again.

The S&P 500 has broken its bearish rising wedge formation (red lines). It has support at 2,900, 2,815, and 2,630.

Provided the US/China trade talks don't completely break down, stocks should hold one of these. Personally I think we'll see the market correct to the low 2,800s or so, at which point the Fed will begin talking up stocks to reflate the bubble.

Again, all of this hinges on the US/China trade talks continuing. If there is a total breakdown resulting in the two sides ending negotiations, things could get REALLY nasty.

Currently, China is copying the same playbook Japan previously used during trade negotiations with the US in the '80s.

That playbook consists of:

1) Promise to do things.
2) Don't actually do them.
3) Drag out the process with more meetings to discuss/ promise to implement changes.

The truth is, if there was a high chance of a deal being struck between China and the US, it would have already happened.

The fact that we've seen this process drag on for over a year already suggests China might be trying to drag this issue into the 2020 elections in the hopes that should President Trump fail to win a second term, his successor would drop the issue completely.

It's worth noting that China has already pushed back the date by which it is required to meet the US's demands to 2025… which would be after President Trump leaves office if he DOES win a second term.

> ***The trade deal that the U.S. and China are crafting would give Beijing until 2025 to meet commitments on commodity purchases and allow American companies to wholly own enterprises in the Asian nation, according to three people familiar with the talks.***
>
> *Talks are continuing in Washington where Chinese Vice Premier Liu He began planned meetings with U.S. Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin on Wednesday.* ***The goal over the next few days is to strike an agreement on the core issues so President Donald Trump and Chinese leader Xi Jinping can hold a ceremony to sign a deal****. Trump plans to meet Liu at the White House Thursday.*
>
> *https://www.bloomberg.com/news/articles/2019-04-03/u-s-said-to-set-2025-target-for-china-to-fulfill-trade-pledges*

If you want proof that China is dragging this process out, note that the above article was published on April 3rd 2019… and suggested President Trump and China's Premiere Xi Jinping might sign a deal on Thursday of that week.

That was a month ago.

Then came the following on Tuesday of this week:

> ***The White House is ramping up pressure to reach a trade deal with China in the next two weeks, warning that the U.S. is prepared to walk away from the negotiations.***
>
> *"It won't go on forever," Mick Mulvaney, President Donald Trump's acting chief of staff, said Tuesday at an event in Los Angeles. "At some point in any negotiation you go,* ***'we're close to getting something done so we're going to keep going.' On the other hand, at some point you throw up your hands and say 'this is never going anywhere.'****"*

"You'll know one way or the other in the next couple of weeks," Mulvaney said, speaking at the Milken Institute Global Conference. ***There's no "fever" on the part of the White House to finalize an accord, he added****.*

After four months of intense negotiations, the Trump administration is making its impatience known, in a shift from mostly optimistic messaging about the prospect of a deal to end their trade war that's resulted in tariffs on $360 billion of each other's goods. U.S. Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin are in Beijing this week for the latest round of talks, with Vice Premier Liu He expected to visit Washington next week.

https://www.bloomberg.com/news/articles/2019-04-30/us-china-trade-deal

If the US and China reach an impasse on trade negotiations, ALL BETS ARE OFF for the markets and the Fed will be forced to intervene just to hold things together.

Remember, stocks have rallied based on two items over the last five months:

1) The hope of the Fed easing soon.
2) The hope of a trade deal being completed between the US and China.

#1 hasn't happened yet. If #2 ends up as failure as well, stocks will have little to cling to.

THAT's when the following chart formation would come into play.

I currently believe the odds of this option to relatively low… provided the debt markets hold up.Credit spread between Junk Bonds and Treasuries look as though they might have broken a rising wedge formation. Right now they are at support. This needs to hold.

It's a similar story for credit spreads between Investment Grade corporate bonds and Treasuries: here again we need to hold support.

Again, both of these charts could just be brief corrections in the context of a bull market… but we need to see them both turn upwards again soon.

The one bright spot is spreads between Leveraged Loans and Treasuries. Here, it looks as though we are about to see an upward breakout.

Provided these three areas of the debt markets remain in strong uptrends, then stocks should hold up relatively well during the coming correction. This would mean stocks finding support somewhere around 2,800 or so.

This is why we had been adding to our long portfolio… specifically with the Emerging Markets ETF (EEM), Nvidia (NVDA) and the European Financials ETF (EUFN).

Feel free to use the current pullback to buy them if you have not already done so.

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 in our regular weekly market update of ***Private Wealth Advisory.***

Until Next Thursday…

Best Regards,

Graham Summers
Chief Market Strategist
Phoenix Capital Research

OPEN POSITIONS

STOCKS PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Total Return*
Energy ETF	XLE	3/21/19	$67.08	$63.66	-5%
Wal-Mart	WMT	3/21/19	$98.73	$101.15	2%
China Tech ETF	CQQQ	4/5/19	$51.90	$50.77	-2%
Uranium ETF	URA	1/17/18	$14.93	$11.90	-20%
Emerging Markets ETF	EEM	5/1/19	$44.00	$43.70	-1%
Nvdia	NVDA	5/1/19	$182.21	$183.19	1%
European Financials ETF	EUFN	5/1/19	$19.62	$19.44	-1%

Position	Symbol	Buy Date	Buy Price	Current Price	Total Return*
Long Treasury ETF	TLT	6/27/18	$120.24	$122.90	4%
1-3 Year Treasury ETF	SHY	2/7/19	$83.68	$83.89	1%
7-10 Year Treasury ETF	IEF	3/21/19	$105.66	$105.32	0%

PRECIOUS METALS/ MINERS PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Total Return*
Gold		3/17/10	$1,120	$1,272.00	14%
Silver		3/17/10	$15.44	$14.64	-5%
First Majestic Silver	AG	5/12/17	$6.59	$5.74	-13%
Gold Mining ETF	GDX	6/6/18	$21.38	$20.17	-6%
Gold Mining Juniors ETF	GDXJ	6/6/18	$30.59	$28.18	-8%

Prices as of 5/2/19 at the market's close.
***Gains include dividends**

BEAR MARKET PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Total Return*
Japan ETF (SHORT)	EWJ	1/3/19	$51.08	$55.25	-8%
UltraShort Russell 2000 ETF	TWM	1/3/19	$18.24	$14.67	-20%
Retail ETF (SHORT)	XRT	1/10/19	$43.51	$45.40	-4%
JP Morgan	JPM	1/10/19	$99.89	$115.41	-16%
Itay ETF (SHORT)	EWI	2/7/19	$25.71	$27.85	-8%
Etsy (SHORT)	ETSY	3/7/19	$67.24	$68.07	-1%
Netflix (SHORT)	NFLX	3/7/19	$352.60	$379.06	-8%

CASH/ CURRENCIES PORTFOLIO

Position	Symbol	Buy Date	Buy Price	Current Price	Total Return*
Australian Dollar	FXA	3/21/19	$71.29	$70.00	-2%

Prices as of 5/2/19 at the market's close.
***Gains include dividends**
**** average of $20.65 and $15.83**