Ode to Mello 04.12.2024

Before I get into the latest market update, want to say a few words about an old friend that just passed. His name is Mello. He was Renate's cat who was with her from before we met over 14 years ago. The old joke I've told many times was, if Mello and I were tied on the tracks with the Wabash Cannonball steaming towards us, and she could only save one of us…well…I better have my ducks in a row. Mello was not an "ordinary" cat with the aloof attitude cats sometimes display. He was more like a puppy dog, always looking for and giving affection. For Renate and daughter Madelyn, he has been a constant companion and a source of joy and comfort in times of tears. So, raise a glass and give your cat some catnip, as we bid adieu to Mello.

(If you wish, please pass on this note to family and friends or go to www.tacticaladvisoryservices.com/market-updates to get a link)

In this note:

- Jinx
- How has the market gone so high?
- What does the data project for the next 6-12 months?
- Concerns – short and long term – deficits, inflation and gold.
- Solutions

The other day I was driving Madelyn and a friend to an event and I asked a question. Both answered the same way at the same time and then both immediately said "jinx!" Of course, the rule is, if two people say the same thing at the same time, whoever first says "jinx," gets to keep talking while the other person must stay silent until the friend or another person says their name 3 times. I remember doing this when I was their age, 50 years ago, and you probably do as well. Anyway, I was thinking of "jinx" when I started this note because I wanted to write a bit on the incredible stock market run the past 5 months that has enriched all who are using our managed and/or structured accounts linked to the indexes. It has been a joy to see your accounts increase so much, especially after the challenges of 2022. My fear is, if I do that, I will "jinx" it and everything will come tumbling down. Of course, that thought is probably a little narcissistic, suggesting I can control the market by what I write, so I've let it go and will continue (although the market was down quite a bit (04.10.2024) when I started this note and is again today (04.12.2024) so maybe I do have power).

There are many problems we read about in our daily news feed and none of them has seemed to matter to the stock market.

1) Ukraine/Russia War; the Israel/Hamas War; Oil shipping problems in the Red Sea
2) Inflation staying high—prices up 36% at the grocery store in the last 4 years^
3) Interest rates remain high, a manufacturing slowdown,* and regional/small banks in trouble^*
4) Concerns about border security and relatively few people happy with our presidential choices.
5) Japan, Germany, and the UK in technical recessions^^

^David Stockman Newsletter 07.13.2023; *https://global-premium.econoday.com/byshoweventfull?fid=598414&cust=global-premium&year=2024&lid=0#top;
^^https://www.zerohedge.com/markets/uk-shows-markets-go-not-down-after-technical-recessions; ^*https://finance.yahoo.com/news/york-community-bancorp-nycb-reports-131005555.html

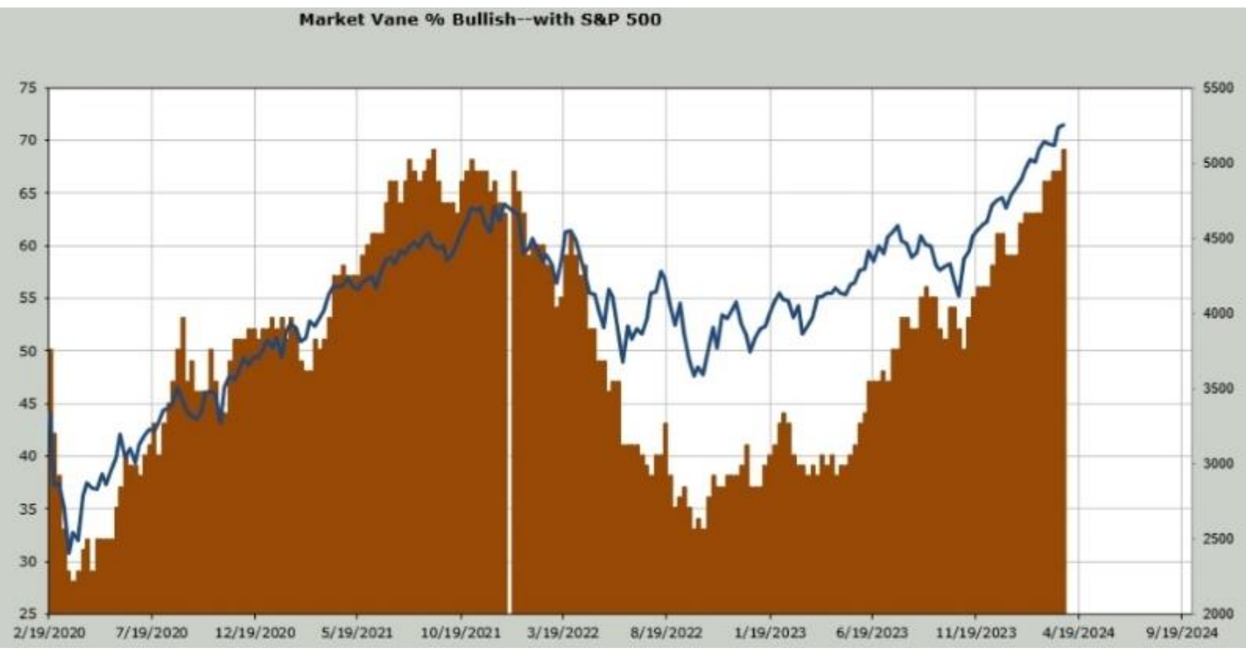
So, what has driven the big gains? Maybe the following?

1) Mass “free” money flowing into the system from the Federal government running $2 trillion deficits in times of low unemployment.
2) Federal Reserve turning on the “Bank Term Funding Program” in May 2023 to allow troubled banks to borrow full value against collateral worth 30% - 50% less than face value.
3) In December 2023 Federal Reserve Chair Jay Powell suggesting a “pivot” in their rates and there would be several cuts in the rate this year with Wall Street pricing in as many as 7 cuts for a while
4) 5 wave market structures deciphered using Fibonacci numbers*

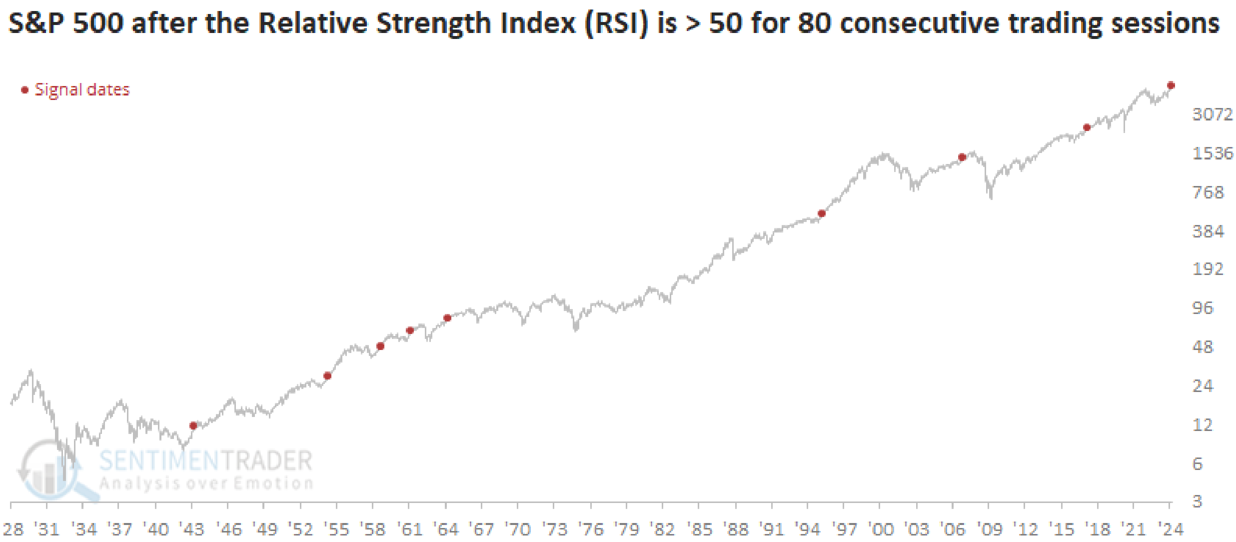
*Elliot Wave Theory stuff – www.elliotwavetrader.net – if anyone wants to discuss this, please let me know

The “real” reason, for my money, is what former Fed chair Alan Greenspan said many years ago:
“Fear and euphoria are dominant forces… Bubbles go up slowly as euphoria builds…fear hits, and it comes down sharply.”
"It's only when the markets are perceived to have exhausted themselves on the downside that they turn."

Notice he said nothing about pivots or stimulus or valuations or interest rates or inflation. It’s all about sentiment. Positive sentiment is now high^ and who knows when it will end. In the chart you’ll see that “bullishness,” as represented by the red area, is now at the same level when the market (dark line) started declining in late 2021. However, those levels in 2021 were first touched 6 months before the downturn began.
^https://users.sentimentrader.com/users/blog/daily_report_03_12_2024

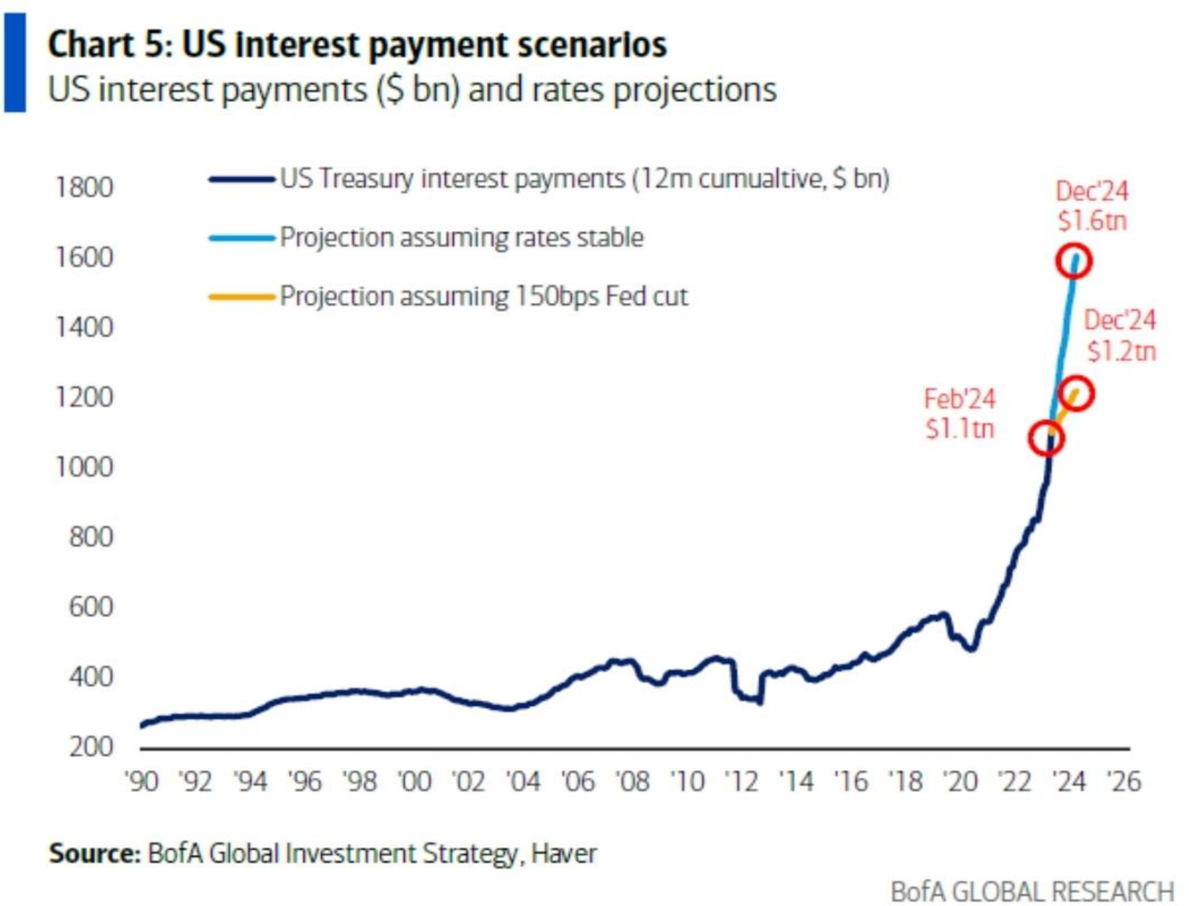


Based on historical data, this run may continue for a while. We’ve now had 5 positive months in a row. Since 1922, when the stock market has had 5 consecutive up months, market results are overwhelmingly positive 9 months later, with the last 24 times all positive (although several were minimal).
*SentimenTrader 03.28.2024



This graph shows when the "Relative Strength Index" has remained above "50" for 80 consecutive market days. Every time that's happened, the market has been positive with excellent average returns 2, 3, 6, and 12 months later. SentimenTrader has published numerous studies over the past couple of months showing when markets have such momentum, gains 6-12 months later have historically been almost all positive. While nothing is foolproof, this certainly seems to bode well for the future. That doesn't mean trouble can't find us. There are some serious issues outlined below.

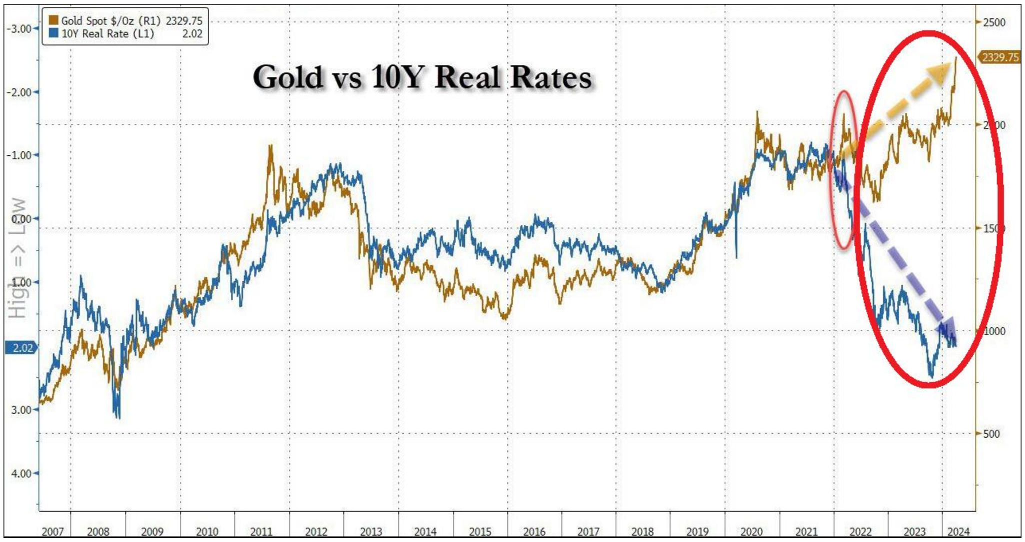
What's bothering me about the market in the short term is, In the past week, we've broken the uptrend channel that began last Nov and we may have now started a new downtrend channel. It wouldn't surprise me to see a 5% correction. While the longer-term data from Sentiment Trader has shown consistently positive returns 6-12 months ahead, the shorter term is more iffy. The important number on the SP 500 price index is about 5090. We've already reduced risk to some degree and below that level I will be reducing risk considerably.



The major concern with most everyone is current interest rates coupled with the $34 trillion federal deficit, more than double what it was 10 years ago.* If anyone ever wanted to see a true "hockey stick" graph, here it is. If rates stay where they are, at the end of 2024, interest payments on the debt will be $1.6 trillion annualized^^ and rising. This is equal to about 36% of all federal government income in fiscal year 2023.^* The entire federal budget was about that amount in the year 2000.^^

I believe the market is finally starting to realize "there's no way out of here" that isn't ruinous to the value of the dollar. 10-year bond rates have risen significantly, about ¾%, since early Feb,^ as the market is demanding a higher rate for buying government debt, making the problem worse. The "challenge" is the Fed must lower rates, end their "quantitative tightening," and start buying government bonds, but inflation is screaming otherwise.

* https://fred.stlouisfed.org/series/GFDEBTN; ^^ https://fred.stlouisfed.org/series/M318191Q027NBEA; ^* https://www.cbo.gov/publication/59730; ^www.finance.yahoo.com;



This last chart shows 17-year gold prices against "real" interest rates, which is the 10-year bond rate minus the government's measure of core inflation. What it indicates is not good. Normally gold/stocks are highly correlated to this rate and usually decline when "real" rates go above 2%. The past 2 years (big red circle) there has been a huge divergence in this relationship. Gold is up about 30% since early Oct 2023, outpacing stocks by 10%. I guessing few people realize gold and the stock markets have increased about the same in the past 5 years.^ My concern is investors are now pricing in the "endgame,"* which is that the Fed is going to be forced to lower rates and/or use debt monetization^^ to prevent US debt service that would "explode into space."

*https://www.zerohedge.com/markets/hartnett-explosion-gold-shows-investors-are-preparing-endgame
^ www.finance.yahoo.com ^^ https://economics.td.com/gbl-debt-monetization

While people often talk about the Fed Reserve "printing money" it has never happened. There are always debits and credits on the ledger. Truly "printing money" is my biggest fear and the reason I have made big changes in the way client accounts are managed the past 2 years as follows:

1) **For managed accounts at Pershing, Nationwide, and now at AXOS, we have been holding larger amounts of "hard" assets, such as paper gold, gold mining and energy stocks, and, at AXOS, along with gold and mining stocks, uranium stock funds and a fund connected to Bitcoin stocks.**
2) **As most of you know, we have diversified into structured contracts using RILAs* and FIAs^ that have gained beautifully in the recent up markets and provide partial or complete protection in down markets.**
3) **We are using fixed accounts paying 5.5% - 6.0%.**
4) **We have moved large amounts of assets into a "mean reversion" strategy^^ that has, historically, performed well in both up and down markets.**

I want you, and me, to be prepared for the worst outcomes down the road so, if/when things start turning upside down, hopefully, we stay right side up. Please contact Deena or me if you want more information on these strategies.

* https://tacticaladvisoryservices.com/buffered-securities ; ^ https://tacticaladvisoryservices.com/structured-outcomes; ^^ https://www.q3tactical.com/investors/

If you've read this far. Thank you. Sorry for the longer read than usual. Please let us know if you need anything.

Enjoy,

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