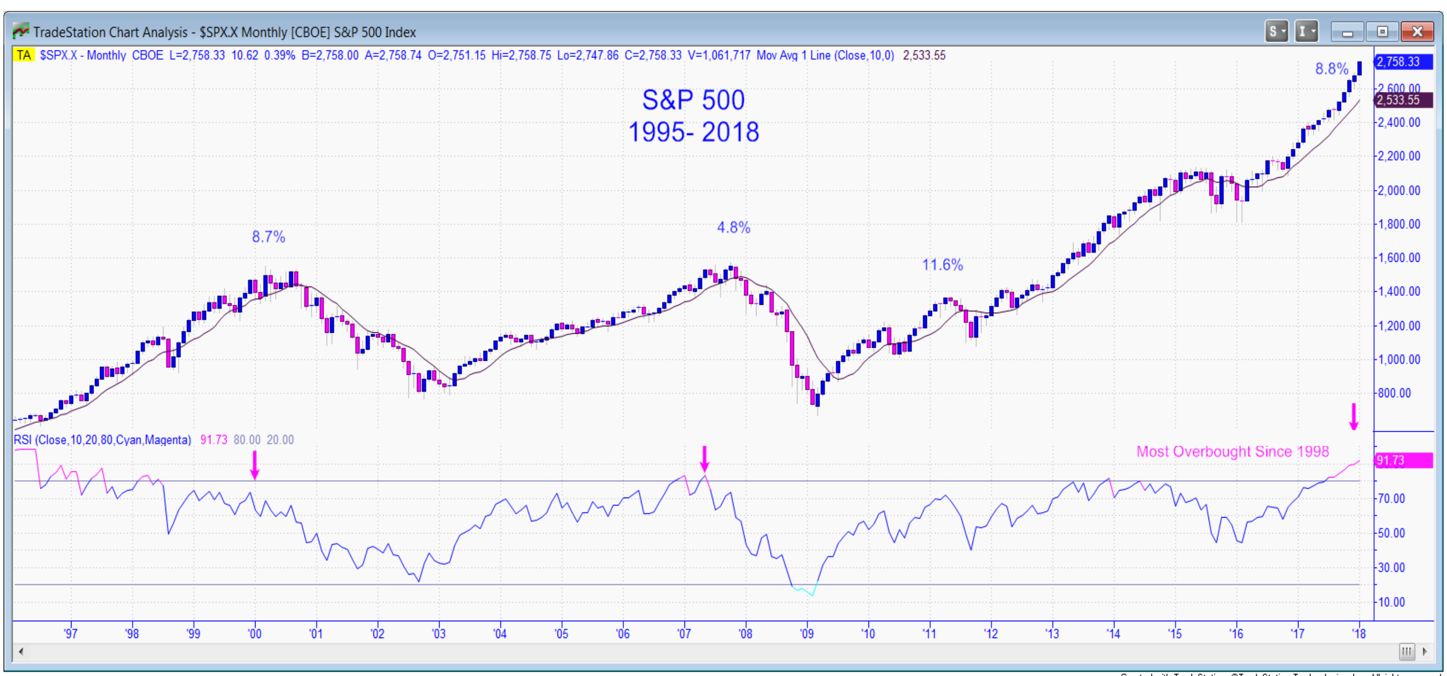
Titan Capital Management, LLC
Global Market Letter

January 9, 2018 **Abe Askil, CFP®**

GLOBAL STOCKS STRONG IN 2017 AND START OF 2018

Global stocks performed very well in 2017 and have started 2018 on a very strong note. The S&P 500 went the entire year without falling 3% or more for the first time in history. A market pullback remains elusive thus far. The European Central Bank (ECB) and Bank of Japan (BOJ) appear to be tapering their asset purchases. This means that their asset buying spree may be coming to an end much like the Fed's Quantitative Easing (QE) program ended in 2015. The ECB and BOJ are still printing money and buying assets, but at a lower rate. This news has already impacted long-term bonds around the world. Investors will be closely watching to see if the stimulus that boosted asset prices over the past 9 years is slowly being taken away. Since the markets are discounting mechanisms, investors will sell on signs that stimulus is being removed rather than wait for it to be completely removed. This will affect most asset classes. The Fed raised short-term rates in December and is expected to raise 2 or 3 more times this year which could take the Fed Funds Rate from 1.50% currently to over 2.00%. The Fed Funds Rate is the interest rate that banks and other depository institutions lend money to each other. Some financial pundits believe that the biggest bubble is in the bond market which has risen for the past 37 years. The 10-year treasury hit 2.54% today and Bill Gross, who is often referred to as the "bond king", is claiming that the secular bull market in bonds is over and a bear market has begun. We shall see if he is correct. We are closely monitoring the global monetary environment as trouble in the bond markets will spill over into other asset classes such as stocks.

Stocks have been very strong during the past year. However, this has left the market in the most overbought position since the late 1990's. The chart below shows the amount in percentage terms that the S&P 500 has been above its 10-Month Moving Average. It was overbought by 8.7% at the market peak in March 2000, 4.8% in October 2007, 11.8% in April 2011, and 8.8% currently. The Relative Strength Indicator (RSI) is shown in the second pane and it reflects a market that is the most overbought since the late 1990's. The down arrows in the second pane show where the RSI was at the market peaks in 2000 and 2007. Notice that it is much higher today than those prior peaks in which the S&P 500 went on to decline approximately 50% on each occasion. Stocks may continue to move higher, but you can see that the market is quite stretched from a historical price perspective. This does not mean that one should go out and sell everything today, but to be aware that we are much closer to the end of the bull market that started in 2009 than the beginning. We will remain fully invested and ride the market higher as long as the trend is up, and our models are positive. However, we fully understand that the current bull market will not last indefinitely and there will come a day when we will be forced to exit stocks.



TAX REFORM PASSES

Now that the tax reform bill has passed, the question most people are asking is "how will this affect me?" While most Americans and corporations will experience tax savings, high income earners who live in the coastal states such as California will most likely not see much savings primarily due to the $10,000 cap for state and local taxes (SALT) and some may pay more in taxes. SALT along with the mortgage interest deduction cap of $750,000 will most likely be negative for real estate prices in these states. There are positives in the tax bill for individuals such as the increase of the standard deduction which will benefit those who do not itemize, the lowering of the top bracket from 39% to 37%, and the increase in the estate tax exemption which will eliminate estate taxes for most Americans. Another positive change is regarding 529 Plans and the ability to use the funds not only for college costs, but also K-12 private school and tutoring costs. Here is a summary of the new changes that will go into effect in 2018:

- Individual tax rates: 10%, 12%, 22%, 24%, 32%, 35% and 37%.
- State & local tax (SALT) deductions which include property taxes capped at $10,000.
- Home mortgage interest deduction lowered to $750,000 from $1,000,000 for new home purchases.
- Charitable contribution deduction has increased to as much as 60% of taxpayers' income.
- Standard Deduction increased to $12,000 for Individuals and $24,000 for Married Filing Jointly.
- Can use 529 college savings plan not only for college, but private schools and tutoring for K-12 grade levels.
- Pass-through businesses can deduct 20% of pass-through income, phaseout limits apply to "professional services".
- Alternative Minimum Tax (AMT) adjusted for inflation, not repealed.
- Estate tax exemption doubled to $11.2 million for individuals and $22.4 million for married couples.
- One-time repatriation tax on corporate earnings held overseas.
- Corporate tax rate lowered to 21% from 35%.

Most of the individual tax breaks are temporary and will expire in tax year 2025. The corporate tax rate is considered to be more permanent. A lot of people are hoping that the lowered corporate tax rate will boost job growth, the economy, and company earnings which will boost the stock market. Time will tell if corporations will use their new-found money to invest in their businesses and hire more employees, or if they will continue to buy back shares of their stocks to increase earnings per share. I believe that it will be more of the latter, but we shall see. The Kennedy and Reagan tax cuts were positive for the stock market, but keep in mind that when the Kennedy and Reagan tax cuts were enacted in 1964 and 1986, the stock market was much more fairly valued with price-to-earnings ratios at 21 and 13 respectively versus 32 today. Here is something else to think about, the 1964 tax cuts did not stop the market from topping in 1966 and trading sideways until 1982 while falling 50% along the way. The 1986 tax cuts did not stop the market from crashing over 22% on October 19th, 1987 a year after the Reagan tax cuts were enacted. Investors are hoping that the tax cuts will be a good substitute for Zero Interest Rate Policies and Quantitative Easing programs of the global central banks. The market may very well continue to rise for another year or two as it did in 1964 and 1986. I would love to see the market go straight up for the next decade, but this is neither realistic nor probable. The reason we have bear markets is because they flush out all of the access and allow the markets to reset. This creates tremendous opportunities for those who have cash and are not stuck holding falling investments. There will be some very good years and some very bad years over the next decade. If we can capture the gains on the upside like we did last year and avoid the bulk of the losses during bear markets, our portfolios will be in good shape.

THE BOTTOM LINE

Our trend models Alpha and Omega are both positive as the stock market rally continues. Global stocks have started the year off with a bang. Emerging market and tech stocks are once again leading as they did during most of last year. This is positive for our strategies as we are allocated to both areas. U.S. stocks are overvalued and overbought from a historical perspective, but we will ride the trend up as long as it lasts. I hope you all have a happy, healthy and prosperous New Year!

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