

Titan Capital Management, LLC

Global Market Letter

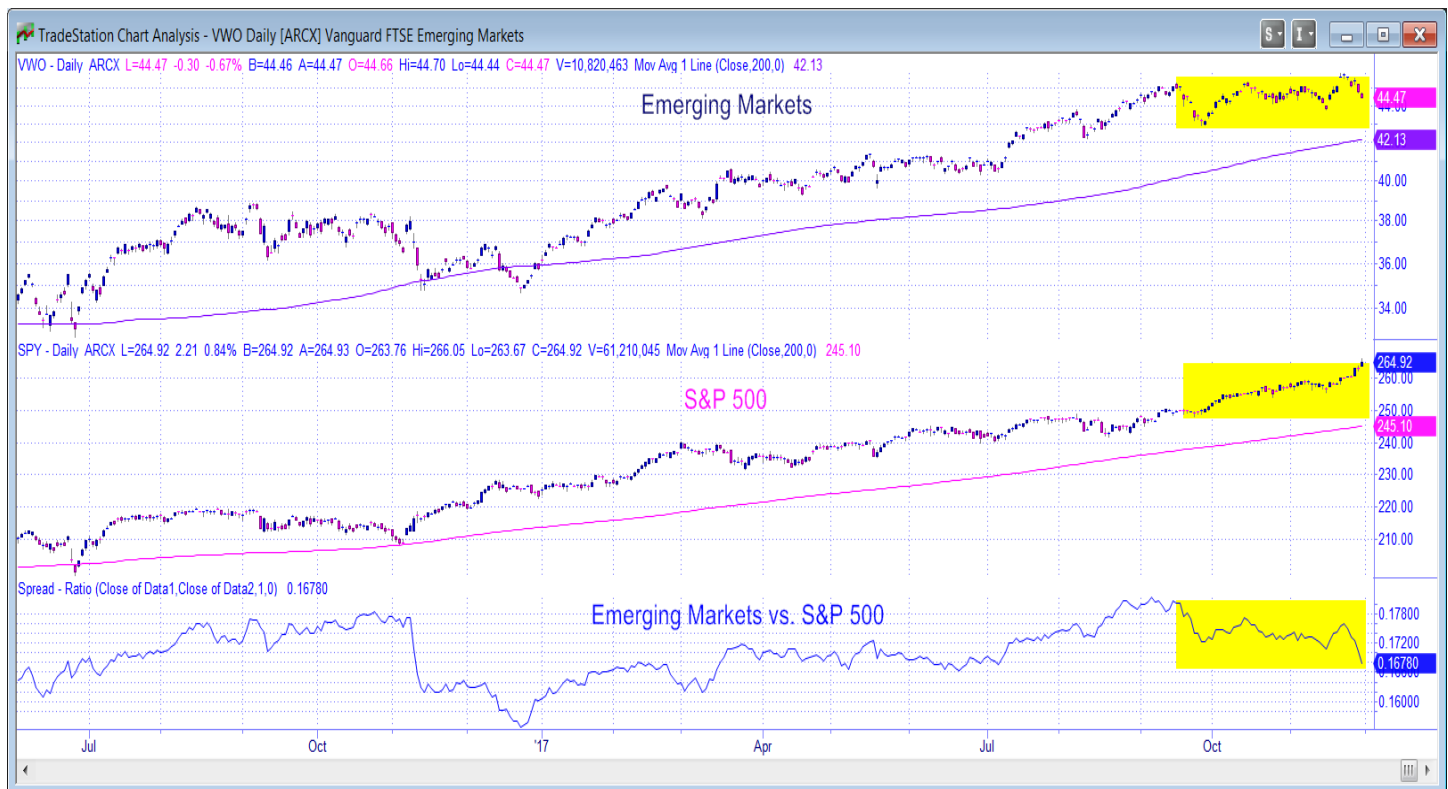
December 1, 2017

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GLOBAL STOCKS CONTINUE TO RISE

The global stock market rally that began in 2016 continues to move higher. The major U.S. indices such as the Dow Jones Industrial Average, S&P 500 and NASDAQ all made new all-time highs this week. For the first time on record the S&P 500 has traded for 12 months without a correction of 3% or more. Something else that has never happened is the MSCI All Country World Index has risen for 13 consecutive months. The low volatility environment that stocks have experienced over the past year is unprecedented and will not last indefinitely. This may even be changing now as the VIX fear indicator has risen approximately 40% this week from 9.67 to over 13 intraday. Many investors have become too optimistic and too complacent. Markets are most vulnerable when they are overvalued and there is very little fear amongst investors. We have seen this time and time again in the past. In the meantime, the financial markets continue to be driven by headlines such as tax reform, North Korea and political uncertainty.

Emerging market stocks were outperforming developed markets through mid-September, but since then they have underperformed. We can see in the first clip of the chart below that emerging market stocks have been in a trading range since September while the S&P 500 which is shown in the second clip has moved higher. The third clip (blue line) shows the performance of emerging markets vs. the S&P 500. The blue line was rising during most of this year which means that emerging market stocks were outperforming the S&P 500. The blue line has declined since September indicating that emerging markets are underperforming. This trend may be short lived and it could be that emerging markets are taking a rest before the next leg up. However, it very well could be the beginning of further weakness for them. If the emerging markets were to break below the yellow highlighted area in the first clip it would be negative. Emerging market stocks have for the most part lagged developed markets since 2009, with 2017 being the exception, which has made their valuations more reasonable than U.S. stocks. Emerging market stocks are much more volatile than developed market stocks so if their underperformance continues it could be indicative of investors wanting to reduce risk. Further underperformance would turn our models negative on emerging markets and force us to rotate out of them.



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YIELD CURVE HEADING INTO DANGEROUS TERRITORY

The yield curve plots the difference between long-term and short-term bond yields. The chart below shows the yield curve of 10-year U.S. treasury yields minus 2-year treasury yields. The 10-year is currently yielding 2.35% and the 2 year is yielding 1.77%, the difference between the two is 0.58. This is referred to as a “flat yield curve” since the yields of both bonds are nearly identical. When the yields of the longer-term bonds are higher than the shorter-term bonds this is called a “steep yield curve” which is generally positive for the stock market and economy. This generally happens when the Fed (or any other central bank) lowers short-term rates. The yield curve has been flattening since 2014 and the last time it was close to zero was in 2008 when the last recession began. The Fed will most likely raise short-term rates in a few weeks which will flatten the yield curve even more and at some point if they keep raising rates, it may invert. We can see in the chart below that since 1980 whenever the yield curve has “inverted”, which means that short-term yields are higher than long-term yields, the economy went into a recession (red shaded areas) and stocks entered into a bear market. The yield curve has not inverted yet, but it certainly may next year. If the economy continues to grow and long-term yields rise, then there is less likelihood of an inverted yield curve. If the Fed keeps raising short-term rates and long-term yields remain flat or decline, then we could see an inverted yield curve that very well could be the pin that pricks the various asset bubbles around the world. After all, the yield curve inversion was the pin that pricked the tech stock bubble in 2000 and the housing and stock market bubbles in 2007. There are very few things that investors fear more than an inverted yield curve.



THE BOTTOM LINE

Our trend models Alpha and Omega are both positive. December has historically been a good month for stocks, especially the last 5 trading days of the month and the first 2 days of January which is referred to as the Santa Claus Rally. Since 1950 the S&P 500 has risen 1.4% during these 7 trading days. We'll see if Santa brings Wall Street a nice present this year or a bag of coal. Investors are not only eager to see what Santa brings them in a few weeks, but also what the Fed will bring them on December 13th. I hope you all have a very Merry Christmas, Happy Hanukah and a Happy New Year!

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