"Treasure Hunt"
Market Commentary – April 2019

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.2% in the fourth quarter of 2018. This is lower than the 2.6% initial estimate (the second estimate was skipped). On March 20, the Fed revised its economic projections that were last released in December 2018. It now sees GDP growth of 2.1% in 2019, 1.9% in 2020, 1.8% in 2021, and 1.9% in the "longer run" (beyond 2021). If these forecasts hold true, they would imply that the economic malaise of the Obama administration would continue for the rest of President Trump's current term. Note that with GDP at these projected levels, a recession is not anticipated (not to imply that the Fed will ultimately be correct on that front).

In its monetary policy announcement on March 20, the Federal Open Market Committee (FOMC) decided to leave its benchmark federal funds rate unchanged at a range of 2.25% to 2.50%. Moreover, the FOMC's famous dot plot shows 11 of 17 FOMC participants believe the Fed should not raise rates at all this year, while the remaining 6 officials believe between one and two 25 basis point increases would be needed in 2019. According to the Quarterly Report on Federal Reserve Balance Sheet Developments released in March, the Fed's balance sheet now stands at $3.975 trillion (down $198 billion from October 2018 and down $419 billion from February 2018). Assets peaked around $4.5 trillion. On March 20, the FOMC also announced its plan to continue trimming assets by $50 billion per month through April. However, it will cut the monthly trimming to $35 billion per month in May 2019 and cut further to $20 billion per month in October 2019. The next announcement on monetary policy is scheduled for May 1.

The annual update of our universe of stocks, which we view as a treasure hunt, has revealed many attractive stocks that have been neglected. We analyzed a total of 1,984 companies one at a time, with a cumulative market capitalization of $34.6 trillion. Our process allowed us to identify "our universe", which is comprised of stocks we believe have the best risk/reward prospects (based on a combination of low valuation, low beta, low debt to market cap, and, usually, high dividend yield). A total of 101 stocks made the cut and have the following market capitalization ranges: $27 million to $500 million (24 stocks), $500 million to $2 billion (18 stocks), $2 billion to $10 billion (26 stocks), $10 billion to $100 billion (27 stocks), and >$100 billion (6 stocks). In the coming months, we will perform in-depth fundamental research on the companies in our universe with attractive technical chart patterns to determine which ones to buy.

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $171.07, which implies a price-to-earnings (P/E) ratio of 16.6 with the S&P 500 at 2,834. The earnings yield (E/P) of 6.04% represents attractive value relative to the 10-year U.S. Treasury note yield of 2.41%. The 10-year yield has collapsed from 3.23% in November 2018 on fears of a pending recession, but the end result is that stocks have been made more attractive at current levels. This has been providing a bid (and thus a floor) to stock prices.

The S&P 500 struggled with resistance around 2,800, as expected, but it managed to push modestly through. Next resistance levels should be around 2,870 (January 2018 high) and 2,930 (all-time closing high in September 2018). Major support levels should exist around 2,750 (200-day moving average), 2,630 (November closing low), and 2,350 (December closing low). Interestingly, the 50-day moving average has rocketed higher in recent weeks and is about to break above the 200-day moving average for the first time since early December. Known to technicians as a "golden cross", this should generate bullish headlines.

The stock market remains a wonderful place to generate wealth, but it can turn dangerous at any moment. Since clairvoyance is not realistic, it is best to remain vigilant and avoid complacency.