Titan Capital Management, LLC
Global Market Letter

November 3, 2017 **Abe Askil, CFP®**

TAX REFORM

Yesterday the GOP released highlights of its tax plan. This tax proposal, which has not passed yet, will affect all of us in one way or another. We don't know how much of the market gains this past year can be attributed to investors discounting tax reform and future economic growth. Stocks may decline if tax reform does not pass, but then again they could also sell off if it does pass as investors may "buy the rumor and sell the news". Here are a few of the proposed changes:

- Individual tax rates will be 0%, 12%, 25%, 35% and 39.6% for those making over $1 million.
- Lowers the corporate tax rate to 20% from the current level of 35%.
- Reduces tax rate on business income to no more than 25%.
- The home mortgage interest deduction will be lowered from $1,000,000 to $500,000 for new home purchases.
- Eliminates the deduction of state income taxes.
- Write off state and local property taxes up to $10,000.
- Repeals the Alternative Minimum Tax.
- Elimination of the estate tax.

These proposals will all be debated over the next few weeks so no one knows how much of this will actually pass. We will keep you abreast of any changes as they will affect us as investors and tax payers.

Global stocks continue to perform well and the major U.S. indices are at or very close to new all-time highs. Emerging market stocks which have performed well this year have been in a trading range since mid-September. Technology stocks continue to lead and many are making new all-time highs on positive earnings reports. Like emerging markets, Tech stocks have also had quite a run this year and our strategies are allocated to both. The chart below shows a cycle composite of various market cycles including the One Year Seasonal Cycle, Four-Year Presidential Cycle and 10-year Decennial Cycle compared to the S&P 500. The blue line is the cycle composite that goes back to 1928. The red line is the actual S&P 500 Index. The S&P 500 has tracked the cycle composite for the most part this year, but diverged in late August. We will see if the S&P 500 continues to rise and diverge from the cycle composite or if it turns down to mirror the cycle composite (blue line).

Chart courtesy of Ned Davis Research

THE EVERYTHING BUBBLE

The past couple of years I have mentioned that for the first time in history stocks, bonds and real estate are all potentially in a bubble. Financial pundits have named this phenomenon "The Everything Bubble". In 2000 we had a bubble in stocks, and specifically technology stocks. In 2007 there was a bubble in real estate and stocks. Today we have a potential bubble in stocks, real estate and bonds. The Everything Bubble also includes: bubbles in crypto currencies such as Bitcoin, bubbles in global central bank balance sheets, an auto bubble, a corporate credit bubble, and a bubble in passive investing. The latter refers to the more than $1 trillion that has moved from actively managed mutual funds to passive funds during the past decade. According to AllianceBernstein, passive funds represent 40% of the market share in the U.S. We use passive ETFs in our strategies, but we are tactical managers and have no intention of holding them when the market turns down. Most investors that have moved into these passive funds either believe that they can handle 30% plus declines or they don't believe that these types of declines will ever occur. They will unfortunately be wrong on both counts.

The table below shows where stock, bond and real estate valuations were during past major market peaks in order to give you an idea of how current valuations compare to prior bubbles. Looking at stocks first, you can see that the Shiller P/E has only been higher during the tech bubble of 2000. Valuations are higher today than the bubbles of 1929 and 2007. Moving on to bonds, treasury yields are much lower today than they have been historically, which means that bond prices are near all-time highs since bond yields and bond prices move inversely. Finally, commercial and residential real estate are potentially in bubbles as well. The Capitalization Rate (Cap Rate) is the rate of return on a real estate investment property based on income that the property is expected to generate. In the year 2000 commercial real estate had a cap rate of 8% versus just 4.4% today which is an all-time low. When the cap rates are low it means that real estate prices are high. The markets are especially venerable to large declines when you add in the record level of margin debt and excessive investor optimism. The markets can certainly continue to rise over the next several months and years. However, trees don't grow to the sky and neither do asset prices.

The Everything Bubble

	1929	2000	2007	2017
Stocks (Shiller P/E)	28.96	39.37	27.32	31.30
10-Year Treasury Yield	3.37%	5.74%	4.53%	2.33%
Real Estate Cap Rate (NCREIF)	NA	8.00%	5.50%	4.40%

THE BOTTOM LINE

Our trend models Alpha and Omega are both positive. Global stocks continue to rise with very little volatility which is historically unusual, especially during this time of the year. There is very little fear amongst stock investors with the VIX at 9.29 which is well below its average of 20 during the past decade. While the major U.S. indices have been moving higher, the 10-year treasury yield is currently at 2.3% which means that bond investors are not buying into whatever stock investors are. Time will tell which market turns out to be correct, but bond investors have a reputation of being more astute than stock investors. Financial markets will be focused on changes to global central bank policies and U.S. tax reform in the weeks and months ahead. I hope you all have a very Happy Thanksgiving!

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