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# ′I can′t wait ′til noon′

Uncertainty climbs as investors interpret a dovish Fed and rally in long Treasury bonds as a possible recession signal. Might it be an opportunity?

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**...was the first comment an advisor made** on Thursday morning. Why, I asked? March Madness, of course, and I waited patiently as he and my colleague discussed brackets, with a clean copy on his neatly organized desk. You know, I have never been asked to fill out a bracket by anyone! And it would be an easy $20!! This week took me to Naples, Fla., ranked by Gallup as the nation's happiest and healthiest city for three straight years. Yes, they're happy, and also plugged in and not shy to voice opinions. My first question of the week came at a client event: "Hey, we've always been a socialist nation (listing as examples, government-funded roads, bridges, fire stations, police, etc.). So what's the big deal (in voting for a progressive president next year)?" In what is becoming a pattern, my attempts to discuss the strong economy and our positive outlook are being interrupted by fellow American investors concerned about the possible outcomes and ramifications of the 2020 presidential election. It was a lively discussion in our private room at lunch, with some notable quotes: "What about us? The little people?" and "A 17-year, 364-day-old is a dummy and can't vote. Next day, he is a genius!" And meeting after advisor meeting, the subject came up. This will not go away! Our promised fascinating election season, along with uncertainties about potential three trade wars (China, Europe and autos, and will the Democrats cooperate to get the United States-Mexico-Canada pact finalized?) will be resolved one way or the other, each binary outcomes that could move the market in either direction.

**If the Fed is close to being done** and the economy/job market looks relatively good, what's up with the 10-year Treasury yield at 2.45%! What's the big deal? Cornerstone Macro posits with a federal funds rate stuck in the 2.4-2.6% range, a 10-year yield in the 2.2-2.4% range makes sense as long as the term premium (the extra yield investors seek above short-term Treasuries to offset the risk of locking money up in longer-term instruments) continues to remain negative, as it has been for most of this cycle. This negative term premium reflects ongoing concern about the ability of the Fed to reach and maintain a 2% inflation target, a theme Powell stressed Wednesday. He also underscored what the Fed has been saying for months, that its current patient stance is appropriate and that it is comfortable watching and waiting. So, why did the risk markets sell off post-statement? And why did the 3-month/10-year Treasury yield curve invert this morning for the first time since 2007? Most likely because the dot plot and projections reflected a U.S. economy that was slowing more than consensus thought, and because of today's new evidence of deterioration in Europe (*more below*). While it's true inverted curves signaled market tops and recessions the past two cycles, it was 2.5 years before either occurred. The Fed is adding to globally synchronized stimulus that has boosted liquidity the world over, with the annual growth of real money supply jumping from less than 1% last summer to almost 3%. Easier financial conditions ought to be enough to keep a recession at bay.

**There's an unusual mismatch in Q1 expectations**, with the Street forecasting rising revenues yet falling earnings on compressed margins, a fairly rare outcome that typically occurs in recessions and late cycle, neither of which we believe to be the case. This adds to arguments earnings could surprise to the upside. There's substantial "dry powder" on the sidelines—JPMorgan Prime Brokerage data shows hedge funds stubbornly net short equities, while money market balances are a 9-year high $3.1 trillion as individual investors have taken money out of stocks and parked it in cash. An impressive reversal of beaten-down cyclical stocks led 2019's strong start—more than nine of every 10 stocks is up year-to-date—but post-January, defensive and growth names have been out front. This week's record high in the New York Stock Exchange Advance/Decline line sent a "good" overbought reading, says Fundstrat, the kind of momentum signal seen at the start of new bull runs in 1987, 1998, 2002, 2009, 2010, 2011, 2016 and 2018. While profit growth has slowed, corporate credit quality is healthy on rising coverage ratios, a declining number of zombie companies and debt reduction that's being financed through excess cash flow and asset sales. None of this is consistent with late cycle. While Brexit, China and potential auto tariffs could spawn near-term volatility, Fundstrat expects pullbacks to be shallow and short-lived. It's going to be a long (and possibly epic) election season, and normally I feel strongly that people put way too much weight on politics as it relates to the economy and markets ... unless there is big policy move such as last year's massive tax cut—markets love that. Now, if the results of the next election bring a big tax hike, the markets will surely notice. That will be a big deal.

**POSITIVES**

- **U.S. soft landing watch** Despite recent slowing, the economy is exhibiting considerable underlying strength, with rising incomes and job growth lifting consumer's assessment of the economy to an 18-year high, according to a new CNN poll, and Bloomberg's consumer comfort gauge to a new high. Also, the Labor Department reported a record high number of job openings in January, and Conference Board leading indicators rose more than expected.
- **Housing green shoots** February existing home sales rebounded strongly, up nearly 12%, their largest 1-month gain in four years. And the National Association of Home Builders said March builder confidence held on to its rebound off late last year's weakness, with current and expected sales at their highest levels since last October.
- **Maybe the Fed doesn't know more than the market knows** Evercore ISI doubts tech stocks would outperform (the Nasdaq was the only major index to close up Wednesday) if the Treasury market was signaling increased recession risk, an oft-cited theme after a more dovish-than-expected Fed caused long Treasuries to rally and the 3-month/10-year curve to invert. It notes most trading is done by mathematically driven computers operated by hedge funds "to wring every morsel

of potentially profitable information out of market data." Short of recession, a low-rate environment typically is good for stocks and dividend payers.

#### NEGATIVES

- **Global soft landing watch** Germany's manufacturing sector shrank in March at its fastest pace in 6.5 years, pushing the 10-year German bund yield below zero for the first time since 2016, and both France's manufacturing and service sectors also slumped back into contraction. Overall, eurozone manufacturing is contracting with activity at a 5-year low.
- **U.S. soft landing watch** A Markit survey showed both manufacturing and services activity slowing to a 21-month low in March. A separate Census Bureau of activity in information tech service industries noted a marked slowdown at the end of last year, with sector revenue expanding at its slowest pace in five quarters.
- **Contrarian negative** Consumer confidence is at very high levels, only exceeded near the highs in the market in 1968, 1998, 2000 and September 2018, Ned Davis says. This suggest most investors are likely already in the stock market.

#### WHAT ELSE

**Shout-out to dividends** The combination of underperformance and good earnings growth has dividend-paying stocks trading at the lowest discount to non-dividend paying stocks in 15 years. Ned Davis notes that nearly a third of the S&P 500 companies have dividend yields greater than the 10-year Treasury yield—a number that likely will grow given a Fed on pause—versus 22% in September and the long-term average of 15%.

**What a time to be alive!** The Energy Department's $500 million "Aurora" supercomputer being built by Intel at the Argonne National Lab outside of Chicago would be the first in the world to reach so-called "exascale" performance—more than a quintillion calculations per second. Making machines quicker at crunching data is expected to help researchers with such as tasks as modeling climate change or finding new pharmaceutical drugs, not to mention give the U.S. a leg up on China.

**I shall only ever visit there** Even tech workers — some of the Bay Area's highest-paid residents — are having a hard time achieving the bedrock of the American Dream, online tech news site Recode says. These workers average 6-figure salaries but increasingly can't afford to buy a house in San Francisco, where the average home value is around $1.34 million.

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