THE National Investor

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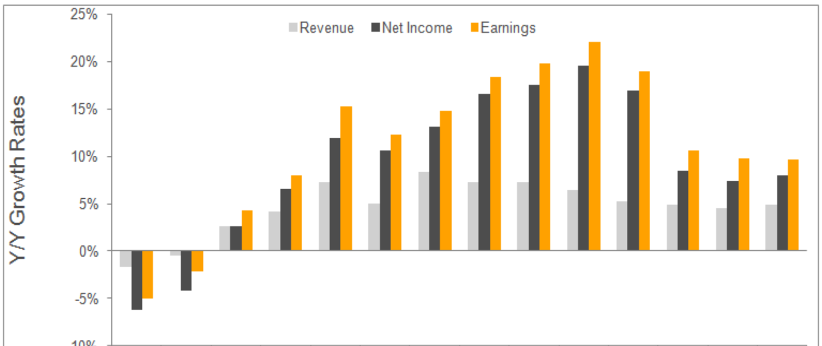
"UNINVESTABLE" MARKETS

The world's two most important stock charts. . .different degrees of trouble

Fortunately, a nice recent run of generating some well-telegraphed short-term trading profits on the couple of significant down legs for U.S. stocks since the beginning of February has our portfolios in nice shape for 2018 so far. And as I said in one of my several recent e-mails to you since the last regular issue, I continue to look for the *next* directional opportunities.

But I'm not ashamed to tell you right now that I have NO strong sense which way things may break in the near term. As I've opined on the podcasts a few times recently, I could paint persuasive arguments for most all asset classes to break up OR down. Where **the U.S. stock market** is concerned, it has managed to fairly persuasively put in that double bottom I've been talking about. Yet, that accomplishment--hailed by market cheer leaders, especially as stocks have managed to slug their way forward once more since that second low point of a few weeks ago--may not be able to stand up given the UGLY performance of Chinese stocks, as I have been ringing the warning bell about! (Nor, I suspect, will the latest rebounds in base metals and energy hold up long, either, if Chinese stocks can't regain some mojo *fast*.)

This latest rally on Wall Street, at least, owes itself to a few sighs of relief that--despite the initial worries and threats back and forth over a much more dire follow-up--the bombing of Syria last Friday night for now appears to be another "one-off." Q1 earnings, as advertised, have generally been to investors' liking by and large as well. **Interest rates at the long end, though, have suddenly woken back up this week (more on this below.)** That has kept the pressure on the major indices, and has specifically kept the S&P 500 from breaking above its down trend line back to February, as you saw on the first page.



	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3
Revenue	-1.7%	-0.4%	2.6%	4.2%	7.3%	5.0%	8.3%	7.3%	7.3%	6.4%	5.3%	4.8%	4.6%	4.8%
Net Income	-6.2%	-4.2%	2.6%	6.6%	11.9%	10.6%	13.1%	16.6%	17.6%	19.5%	17.0%	8.4%	7.4%	8.0%
Earnings	-5.0%	-2.1%	4.3%	8.0%	15.3%	12.3%	14.8%	18.4%	19.8%	22.1%	19.0%	10.6%	9.8%	9.6%

Sources: Thomson Reuters I/B/E/S, Thomson Reuters Proprietary Research

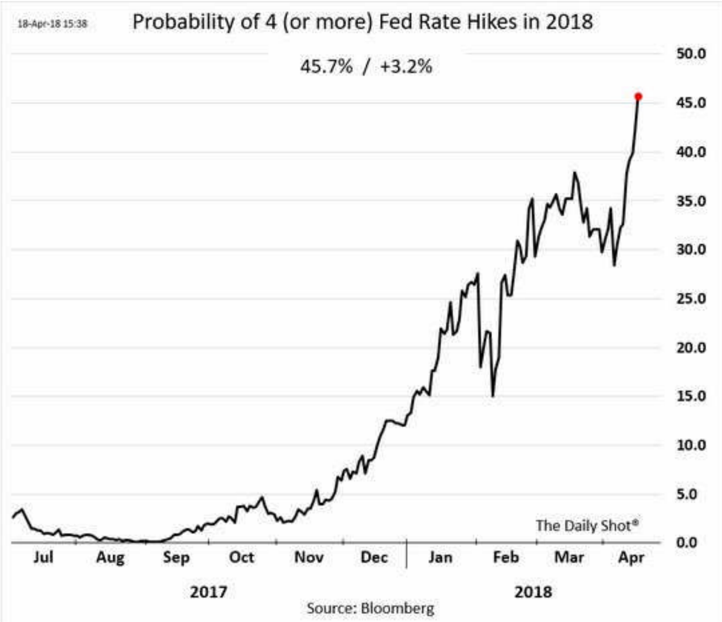
Though the environment for U.S. stocks is certainly less bad now than it's been, it still seems uninvestable to me *generally*. Yes, the stronger earnings are nice; yet everybody and their dog has *already* factored this into their thinking. The earnings spurt we'll see for much of 2018 was the key reason stocks scorched higher through January. It's questionable whether--lacking any fresh, legitimate economic impetus--there will be much juice left.

As I have suggested a few times recently, these stronger earnings--due in great part to the front-loaded nature of tax cuts, more so than organic economic growth to a great extent--are *yesterday's news*. More likely now is that Wall Street will be looking toward the possibility of the Democrat Party winning one or both houses of Congress in November.

Further, we have this never-ending litany of *potential* disruptors--Syria, Russia, China, trade disputes, reckless Tweets, Mueller, et al--**which are likely to keep most traders in the "sell the rip" mindset they have adopted since February's jolt.** So as for the broad market--barring some sufficiently meaningful new ingredient(s) that adds factors we aren't looking at now--it doesn't seem safe to me to make much of a bet in *either* direction. For now, we will first have to see if the S&P 500 is able to break that down trend line sooner rather than later. If it *does*, the next step will be to get back to the twin peaks from late February and mid-March, and at least allow stocks to establish a relatively safer "sideways" range. *On the down side*, barring a very nasty negative turn where one of those geopolitical issues is concerned or some other unexpected market move that causes hearts to skip a beat, the recent double bottom around 2530-ish on the S&P *should* hold for a while; unless, that is, the 10-year Note *crashes* through the 3% level and keeps going.

Nevertheless--and though I have a fairly high recommended allocation to cash right now--I'm mulling over adding more individual companies (and maybe an ETF or two), chiefly along the themes I discussed in Monday's e-mail.

IF ANYTHING, THE FED IS BECOMING *MORE* HAWKISH



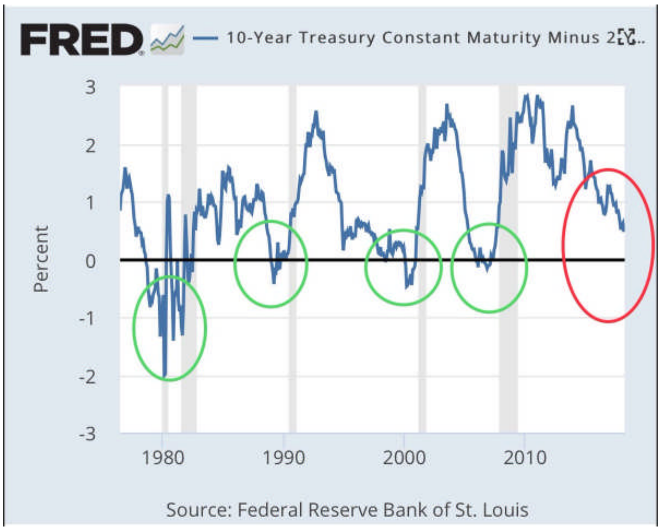
It's weird. For so long, we lived in a world where Fed officials regularly cried "Wolf!" As other central banks at least attempted to "normalize" policy after the emergency measures following the 2008 financial crisis, the Fed *talked* a lot about doing so, but never DID anything for the longest time. During that stretch, Yours truly had as my favorite quip that "The Fed will raise interest rates again when the Cubs win the World Series."

And I didn't miss by much!

So it's understandable that the markets have been a bit slow in coming around to actually believe the now Jerome Powell-led Fed when it suggests that, if anything, the pace of "normalization" will *pick up*. As I have said numerous times of late, if the markets were *truly* convinced that the federal funds rate was going to go up by *another* full 2% or so by the end of 2019, The Odd Couple (long-term Treasuries and gold) would not be so resilient...and the S&P 500 would *already* have broken below its double bottom.

This past week has seen some renewed acknowledgment that maybe--just maybe--the Fed isn't crying "Wolf!" anymore. Singing from the same song sheet more than they have in recent memory, Fed governors and bank presidents aren't that far apart all of a sudden in their views that--YES--it's justified to have rates *still* rising incrementally for the foreseeable future. They are getting some cover from crude oil having recently led the commodity complex higher, boosting what already was becoming a slow but sure bubbling up of inflation. Assuming that oil holds most of its gains (let alone *adds further* to them) it's a lead pipe cinch that even the Fed's downward-massaged price deflators will keep rising, all else being equal.

Listening to most of these sorts, no matter how weak the reading for Q1 GDP turns out, **the Fed is already looking past that.** It is convinced that *at the least* the markets will continue to stay *liquid* enough (Note that I did not say *high enough*) that they can continue on their present course. After all--as I have said more times than I can count going back to last June's pivotal Epiphany that then-Chair Yellen caused some of us to have--**weakening economic news now will do no more to slow down the Fed than strengthening economic news (and considerably higher inflation readings than we see now) moved the Fed to start raising rates from 2011 onward**.



This is inevitably going to cause the Treasury yield curve to flatten further. Especially when we get to and past the next hike in the federal funds rate (almost certainly coming in June) the recent post-crisis low of about a 43 basis point difference between the two and 10-year Treasury notes will be even narrower. If it's not, it will be because the long end is moving past its earlier-year high close of 2.95% on the Ten. Either way, still-spoiled stock markets (which by this time will probably have made new lows for 2018) will be getting increasingly apoplectic over the Fed risking a recession...or a bigger meltdown in the prices of risk assets.

Investors will never be able to say they were not warned if the Fed does "break something," by being too aggressive in the end:

* As I reminded on yesterday's podcast Chairman Powell has indicated that a more severe sell-off in Treasuries will NOT prompt him to contemplate any changes to the central bank's present program to whittle down its balance sheet (the recording available for you at http://www.kereport.com/2018/04/19/10-year-29-usd-moving-higher/)

* Earlier this week, outgoing New York Fed President Bill Dudley--when asked about what kind of a drop in the stock market would cause the Fed to change course--somewhat hypocritically reminded *CNBC's* Steve Liesman that the level of stock prices was NOT a part of the Fed's mandate. Dismissing out of hand Liesman's pointing out the many triple-digit drops in the Dow over the last few months now, Dudley said, "Well, I mean, as long as market function is good, you know, there's people that can actually execute at prices close to the last price then it's not a problem. . .The Fed's mandate is maximum sustainable employment and price stability. There's nothing about the level of the stock market."

Now, I say "somewhat hypocritically" because there have been numerous times that Dudley has discussed the importance of asset prices. **But that's not the *present* Fed narrative; again, something that is not yet fully acknowledged by the markets, in my view.** To most if not all the Fed officials, it seems, they'll only *really* worry about things--and change course--AFTER they have broken something (as Dudley said after Liesman had to almost drag it out of him, for example, if stocks "...went down dramatically and stayed down for a long period of time..." and *that* led to truly stressed financial conditions and threats to the economy.)

Also becoming more "devilish?"

* Last but not least, there's coverage on *MarketWatch* this morning that a woman who had been one of the more reliably "dovish" governors at the Fed was galvanizing her own move toward that early Volcker-like devilishness. In an article by Victor Reklaitis, Lael Brainard

in her latest speech is now sounding caution over "financial imbalances" and "elevated" asset prices *still*. Implicitly, she is suggesting that the Fed's normalization needs to continue in order to get rid of some of these excesses. (Read this whole piece at https://www.marketwatch.com/story/watch-out-as-even-fed-doves-fret-about-markets-living-in-la-la-land-2018-04-20.)

Notably--and as I've discussed a few times since--Brainard had previously dropped her caution on normalization/tightening on *economic* grounds as well. In a well-covered speech in New York she spoke of how she had seen what had been economic headwinds turn into tail winds. Thus, while the former had caused the central bank to tread carefully where "normalization" was concerned, **an economy enjoying these tail winds may now warrant a *faster pace* of tightening by the Fed.** And in her own discussion today (Friday, as I write this) with *CNBC*'s Sara Eisen she repeated her confidence in "synchronized global growth." Check that out at https://www.cnbc.com/video/2018/04/20/were-seeing-synchronized-global-growth-fed-gov-lael-brainard.html.

All the preceding is why the long end of the bond market woke up so suddenly this week. In short order, we're right back at the previous 2018 high for the 10-year Treasury note. Further, the speed of this move--and the fact that yields on Friday closed near their high *despite the sell off for stocks*--suggests that the 3% level will be breached soon (even if afterward, in another pull back for yields, traders have to fill the gap you see in the chart at left.)

The hope everyone has, of course (not the least of which are Fed officials themselves) is that IF we are still going to go somewhat higher in yields at the long end for a spell, it is done in a fairly orderly manner. . .occurs with some lingering optimism that growth will still continue at a healthy pace. . .does NOT yet cause any *liquidity* issues in the markets. . .and especially for our purposes/desires, it fosters a healthy rotation in the market into *value*.

I do not regret for a moment, though, suggesting that you sell TBT and TMV near the last peak for yields. If I thought rates were going to go much higher I would; and would even tell you to get back into those trades. But if we do push much past that 3% level for a while, it won't be by much. Among other things it will become somewhat self-correcting; as we saw when the 10-year Note fell back to near 2.7% recently. Fears of those higher rates causing a recession sooner rather than later will re-emerge; that and more slow bleeding for stocks will put a bid right back into the long end of the Treasury market. So between now and then (assuming we DO move higher for a bit) there simply isn't enough potential gain out there any more to suggest taking the risk of shorting Treasuries anew.

One thing IS clearer than ever, though: and that is the Fed not only doesn't fear more in the way of overdue corrections for asset prices, *but welcomes the prospect*. If you think, for instance, that junk bonds are worth hanging around in, consider Governor Brainard's singling them out in her comments yesterday (and she's not the only one who has done sop of late.) Even stocks are ripe for further declines; provided, of course, that the market remains *functioning* normally.

Will the Fed react if things go REALLY haywire in the markets. . .a geopolitical hot spot flares up. . .or some other malady befalls us? Of course they will. *But even here*, don't expect an immediate act by Powell and Co. to run up the white flag and immediately reverse course. The most plausible thing they might do is simply to hit the "pause" button. Investors won't like it; but the Fed will want to save face and act as if IT sees no reason to panic.

A "RIP YOUR FACE OFF RALLY" FOR...*THE U.S. DOLLAR!?*

If traders for most of the Trump presidency are having a hard time coming to groups with the new reality of a two-way stock market (let alone the chance of a sustained period of weakness now) they may be about to get *another* jolt that changes what they were getting used to again.

And that jolt could be a *significant* rebound in the U.S. Dollar Index.

Now, to be sure, I don't expect the size and profitability of the "Rip your face off rally" I see coming for **uranium**, as you know. I make the characterization in the headline above, though, because traders are likely to be similarly startled at *the move* I see taking shape for the greenback; one that--for a while--will make hash out of the latest rally attempts for most commodities and even for gold (though, as I opined on *today's* podcast at http://www.kereport.com/2018/04/20/rule-run-usd/, gold would probably be harmed the least.) And it may not do the broad stock market a heck of a lot of good either; *indeed, declining stocks and a rallying dollar would probably feed off of each other*.

As I said on the podcast, the British pound is selling off anew. There are numerous reason why the euro is unlikely to breach its recent highs versus the dollar also. Commodity currencies like the Canadian loonie would roll over more sharply. About the only fiat currency that might strengthen with the dollar would be the Japanese yen, as I explain; and if you see IT taking off also, it will probably mean that risk assets and commodities will correct longer.

Even here, though, I still have to consider currency markets "uninvestable" right now. I have a high level of confidence that the USD Index will *at least* make it back to that 93 level, or so, as I explain.

The scant gains that would give us in a long dollar or short euro currency ETF aren't worth the trouble of fooling around there, though. *But I AM looking at other trades that will allow us to take advantage of this; you may get them, in fact, at about the same time you'll be reading this issue*!

In a "perfect world," the USD Index will get to that previous support level of the old trading range for the greenback...but find that it is now *resistance*. Perhaps by then (or *in conjunction with* this dollar rally and against the backdrop of a hawkish Fed) more cracks will appear in that "synchronized global growth" narrative. Corrections in commodities and stocks will have wrung inflation worries back out of markets as fast as they have re-entered them; and DEFLATION fears will increase anew.

In that perfect world, the Fed will see fit to at least hit that pause button...the markets will breathe a sigh of relief...and for a while, it will be time to re-load portfolios with a lot of GOOD stuff that in the mean time will have become quite a bit cheaper. Time will tell.

The above is an excerpt from an expanded NEW issue of *The National Investor* that will be sent to our Members at the beginning of the week.

The new issue adds analysis on gold, crude oil and commodities. . .China's looming breakdown (referred to on the first page) and how we may play that. . .

It includes a broad update on Ecuador and each of my recommendations in that country (in light of the NEW revelations regarding Cascabel and otherwise!

And I also provide updates and guidance on several other of my recommended companies.

To make sure you get ALL of that and the new recommendations I'll be making at the beginning of the week, go to https://nationalinvestor.com/subscribe-renew/ to make sure your Membership is current, if it isn't already!

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