Weighing the Week Ahead: What is the Message of the Market?
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We have a quiet week for data. The ObamaCare drama is finished for now. The Fed meeting is over. Earnings season is past the peak. Don’t worry! The punditry will find something new. Analysts will look deeply into the charts and ask:

What is the message of the market?

Last Week

Last week the economic news was good, but mostly ignored.

Theme Recap

In my last full WTWA (two weeks ago) I predicted efforts to find some new worries. The old set seemed to be running out. There was a fair amount of discussion on this theme, although nothing really dominated. In some ways, it set up the topic for the week ahead. The reception to the abbreviated WTWA last week was great. Thanks to those who read and commented (especially at Seeking Alpha). This makes the articles more valuable for everyone, including me! I’ll continue this plan on other occasions when I have a weekend off.

The Story in One Chart

I always start my personal review of the week by looking at this great chart from Doug Short via Jill Mislinski. She notes the strong Friday trading, leading to a new all-time high.
Doug has a special knack for pulling together all the relevant information. His charts save more than a thousand words! Read the entire post for several more charts providing long-term perspective, including the size and frequency of drawdowns.

The News

Each week I break down events into good and bad. Often there is an “ugly” and on rare occasion something very positive. My working definition of “good” has two components. The news must be market friendly and better than expectations. I avoid using my personal preferences in evaluating news – and you should, too!

Once again, the economic news last week was good. The market got a little boost.

The Good

- **Railroad traffic increased again** up 8.4% year-over year (Calculated Risk).
- **Corporate earnings** have been strong on all fronts: improvement over last year, beating expectations on earnings, and beating expectations on revenues. FactSet details this important story for investors, illustrated by the chart below. Brian Gilmartin emphasizes how this has affected forward estimates and the expectations for stocks.
- **Company comments have been solid.** Avondale does a first-rate job of identifying and reporting trends in conference calls. Look for yourself, but it seems to support the modest growth that we see in economic indicators and earnings. There is special strength in industrial sectors.
- **High-frequency indicators** are positive. New Deal Democrat’s excellent weekly post monitors data you would otherwise miss. It is a valuable addition to the major reports.
- **Tax revenues are surging.** Jed Graham (IBD) has the story.
ISM non-manufacturing registered 57.5, a gain of 2.3 over March. Calculated Risk has the details as well as this chart.
• **Employment reports were strong.** This week is a good test. There are so many aspects to these reports that you can always find something to complain about. This week, while not perfect, included more jobs, more private jobs (Calculated Risk on the ADP results), lower unemployment, and solid labor force participation. Rather than my usual exposition of the highlights – all good this time – I will include the deep analysis from Dr. Robert Dieli, who writes a great report on employment each month. (I do not have a current promotion agreement with him, but reach out and he will probably give you a trial report or two. You will be impressed). Here are the recent complaints. You will notice that perma bears on the economy (no matter how long they have been wrong) ignore these points and move on to some other idea. There is probably a “silver bullet” award lurking for anyone who wanted to look into this.
  ○ Remember all the complaints about the labor force?

![Chart 22 Civilian Labor Force](image)

Now, back to the regular rotation, so that we can get back to the other juicy details.

As noted last month, this series continues to make wide swings within an upward trending channel.

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• How about the claim that jobs were only for part-timers?
And the lack of full-time jobs?
And this is “hard data.”

The Bad

- China’s Peoples’ Bank may be doing some spinning about bad loans. Benn Steil and Emma Smith (CFR) have the story, including this chart:
- The ISM manufacturing index missed expectations, registering 54.8. This still indicates GDP growth of 3.6% for the month and 4.1% for the year. I suspect that the need to update their correlations, but it is probably stronger than the official and oft-revised GDP measure. Here are the details.
The Ugly

Problems in the ETF world. Investors have been flocking to ETFs that supposedly meet specific objectives and have very low costs. This week there were stories about three different problems:

1. A rush of new investors, straining the capacity of the fund. This happened to the gold juniors (GDXJ). When the managers were forced to add new names, redemptions sent the price much lower.
1. A four times leveraged fund that tracks poorly for anything longer than a day or two. Nice work by Phil Huber.

2. And the ugliest of them all – how a closed-end fund can seem to be providing yield while merely giving your own money back. Want a 26% return? Eric Newman with a HT to Josh Brown.

The Silver Bullet

I occasionally give the Silver Bullet award to someone who takes up an unpopular or thankless cause, doing the real work to demonstrate the facts. This week’s award goes to CXO Advisory, a subscription service which maintains a number of great resources for investors. The methodology is always first-rate, and often surprising. This week they take on the “sell in May” meme that we are all hearing. The basic conclusion is that the May – November period is weaker in growth than the rest of the year, but still adds to your returns. Here is the key chart:
See also a similar post from David Keller, who takes a multi-cycle trading perspective.

We should all encourage those who fight slogans with data.

The Week Ahead

We would all like to know the direction of the market in advance. Good luck with that! Second, best is planning what to look for and how to react. That is the purpose of considering possible themes for the week ahead. You can make your own predictions in the comments.

The Calendar

We have a normal week for economic data, but with few important reports.

The “A” List

- Michigan sentiment (F). May preliminary A good read on employment and economic well-being.
- Retail sales (F). A big rebound is expected for the April data.
- Initial jobless claims (Th). Is the series edging up from record low levels?

The “B” List

- JOLTS (T). The analysis of job openings is important for labor market structure and tightness.
- PPI (Th). Eventually, this will matter, but not until there are a few hot months.
• CPI (F). See PPI above.
• Wholesale inventories (T). Highly spinnable March data.
• Business inventories (F). People see what they want – anticipated demand or unsold goods.
• Crude inventories (W). Recently showing even more impact on oil prices. Rightly or wrongly, that spills over to stocks.

With last week’s meeting over, the Fed speakers are out in force, including a sponsored conference on Thursday. Earnings reports continue. While the market is calm about the French election, we will know for sure about the time you are reading this.

Next Week’s Theme

Whenever the week is a bit light on A-level news, it creates a vacuum. It does not change the need to fill on-air minutes or column space. If nature abhors a vacuum, the punditry hates it even more! If they do not see something truly significant, they merely look more deeply to find a topic. Surprising news next week — something important like another onboard airline incident? – would work. Barring that, look for an extra-deep analysis of every market, with the question:

What is the market message?

There is plenty of grist for this mill:

1. What does the “fear gauge" tell us? Some warn because the VIX is so low that it is not representing the level of fear they see. Others suggest that a low VIX implies trouble ahead. (Value Walk).
2. Are economic indicators failing? “Soft" data misleading?
3. What is the message from bonds?
4. Are some more important than others?
5. Do chart patterns show weakness? JP Morgan sees “red flags.”
6. If so, in what time frames? Fear and Greed Trader sees a likely breakout.
7. Some indicators imply future strength. (Todd Sullivan).

As usual, I’ll have more in my Final Thought.

Quant Corner

We follow some regular featured sources and the best other quant news from the week.

Risk Analysis

Whether you are a trader or an investor, you need to understand risk. Think first about your risk. Only then should you consider possible rewards. I monitor many quantitative reports and highlight the best methods in this weekly update.

The Indicator Snapshot
The Featured Sources:

**Bob Dieli**: The “C Score” which is a weekly estimate of his Enhanced Aggregate Spread (the most accurate real-time recession forecasting method over the last few decades). His subscribers get Monthly reports including both an economic overview of the economy and employment.

**Holmes**: Our cautious and clever watchdog, who sniffs out opportunity like a great detective, but emphasizes guarding assets.

**RecessionAlert**: Many strong quantitative indicators for both economic and market analysis. While we feature his recession analysis, Dwaine also has several interesting approaches to asset allocation. Try out his new public Twitter Feed.

**Georg Vrba**: The Business Cycle Indicator and much more. Check out his site for an array of interesting methods. Georg regularly analyzes Bob Dieli’s enhanced aggregate spread, considering when it might first give a recession signal. His interpretation suggests the probability creeping higher, but still after nine months.

**Brian Gilmartin**: Analysis of expected earnings for the overall market as well as coverage of many individual companies.
Doug Short: The World Markets Weekend Update (and much more). His Big Four chart is the single best method to monitor the key indicators used by the National Bureau of Economic Research in recession dating. The latest update now includes the employment data.

Menzie Chinn at Econbrowser also reviews these key indicators, suggesting no recession.
Readers know that I recommend being politically agnostic when it comes to your investments. That said, investing wisely depends upon knowing the likely impacts of various policies. I came from an intellectual tradition of “speaking truth to power” whether it was popular or not.

This new section will provide some food for thought – basic policy analysis on important topics. I will include only a brief overview. Those interested should dig into the source material, planning to spend a little time.

For our first topic, let us consider trade issues. My friend and former colleague Marty Finkler is putting his retirement time to good use. I encourage following his new blog. You really need to read the entire post, but this chart of the G7 share of world GDP will surprise most:

How to Use WTWA (especially important for new readers)

In this series, I share my preparation for the coming week. I write each post as if I were speaking directly to one of my clients. Most readers can just “listen in.” If you are unhappy with your current investment approach, we will be happy to talk with you. I start with a specific assessment of your personal situation. There is no rush. Each client is different, so I have eight different programs ranging from very conservative bond ladders to very aggressive trading programs. A key question:

Are you preserving wealth, or like most of us, do you need to create more wealth?

Most of my readers are not clients. While I write as if I were speaking personally to one of them, my objective is to help everyone. I provide several free resources. Just write to info at newarc dot com for our current report package. We never share your email address with others, and send only what you
Best Advice for the Week Ahead

The right move often depends on your time horizon. Are you a trader or an investor?

Insight for Traders

We consider both our models and the top sources we follow.

Felix, Holmes, and Friends

We continue with a strongly bullish market forecast. Most of our models are fully invested. RoadRunner is fussy about entry criteria. The group meets weekly for a discussion they call the “Stock Exchange.” In each post I include a trading theme, ideas from each of our five technical experts, and some rebuttal from a fundamental analyst (usually me, but this week Cody Willard took that role). We try to have fun, but there are always fresh ideas. Last week the group demonstrated how your choice of time frame affected your interpretation from the chart. Cody joined in with expert commentary (see more from him at Trading with Cody and mention WTWA in asking for a free trial) about the long-term fundamentals of a near-consensus pick in our group – Nvidia (NVDA). If you have never checked out this series, please look at this one — a great insight into why there is no “right” strategy.

Top Trading Advice

Brett Steenbarger is required reading for traders, posting many great ideas almost daily. My favorite this week is his discussion of trading stops. He explains why weaker traders get it wrong and complain, while experts are taking profits and limiting losses. A great topic!

He also explains why traders should always be updating their methods – and provides a fresh idea.

Gatis Roze takes up a theme I have often mentioned: keeping a trading journal. He looks back over five years, but I think a shorter time frame is still a good idea. He breaks the trades into four interesting categories:

1. Good losers
2. Bad losers
3. Winners
4. Tenbaggers

You might guess the logic, but read the whole post for a nice explanation and some examples.

Adam H. Grimes discusses stock screens with an emphasis on traders. It is in podcast form, but regular traders may well enjoy this. I note that the stock screen trading concept is essentially what our models do.
Insight for Investors

Investors have a longer time horizon. The best moves frequently involve taking advantage of trading volatility!

Best of the Week

If I had to pick a single most important source for investors to read this week it would be Chuck Carnevale’s post, The Most Important Stock Investment Lesson I Ever Learned. The title should make everyone sit up and take notice. It also ties in nicely with this week’s theme, which Chuck challenges. He focuses on a Seth Klarman principle via Vishal Khandelwal:

“Don’t seek Mr. Market’s advice.

Some investors – really speculators – mistakenly look to Mr. Market for investment guidance.

They observe him setting a lower price for a security and, unmindful of his irrationality, rush to sell their holdings, ignoring their own assessment of underlying value. Other times they see him raising prices and, trusting his lead, buy in at the higher figure as if he knew more than they.

The reality is that Mr. Market knows nothing, being the product of the collective action of thousands of buyers and sellers who themselves are not always motivated by investment fundamentals.

Emotional investors and speculators inevitably lose money; investors who take advantage of Mr. Market’s periodic irrationality, by contrast, have a good chance of enjoying long-term success.”

So much for trying to get a message from the market. Chuck goes on to explain the fundamental factors that should be part of your analysis.
**Key Concepts**

We can always learn from the greatest. This Peter Lynch interview includes a wonderful story about a pick gone wrong. He also explains why work pays off for the value investor — turning over more stones. This fits nicely with some of our featured posts below.

Be sure to read the news from the Berkshire annual meeting. Seeking Alpha has a live blog.

**Stock Ideas**

Barron’s has a feature on Amazon and a nice column on tech stocks.

Marc Gerstein executes a clever stock screen discover non-financial candidates that might do well in a rising rate environment. He discovers that there were few candidates until a year ago. Very interesting. His list is worth further study.

Blue Harbinger starts with 100 high-yield stocks that declined last week. He narrows down the field to ten that you might consider.

William Stamm recommends a look at Omega Healthcare Investors (OHI). This name popped up in several of the articles I read this week, and we hold it for some clients.

Our Stock Exchange always has some fresh ideas. There are ideas from five different approaches. This week several models agreed – for a change! Take a look at the post for analysis of Nvidia (NVDA) in multiple time frames and strategies.

**Personal Finance**

Professional investors and traders have been making Abnormal Returns a daily stop for over ten years. If you are a serious investor managing your own account, this is a must-read. Even the more casual long-term investor should make time for a weekly trip on Wednesday. Tadas always has first-rate links for investors in his weekly special edition. As usual, investors will find value in several of them, but my favorites are the two posts on how much you really need in cash and assets.

I have emphasized the regular personal finance feature at Abnormal Returns, but the offerings have become much more diverse. I follow them all, often finding items of personal interest as well as ideas for WTWA. If you have not recently checked out the site, it is time for another look. You can also get special benefits by becoming a member.

Seeking Alpha Editor Gil Weinreich’s series for investment advisors is useful for individual investors as well. The well-chosen topics span important questions and provide helpful links. This week he featured an intriguing psychological study about risk and reward. Imagine that you were offered a payment to walk to the end of a 10-meter diving board…..But I don’t want to spoil a good story.
Grocery stocks. The competition is heating up. Craig Giammona (Bloomberg) analyzes five forces. A German invasion?

Final Thoughts

What should we think about today’s “market messages”? I want to emphasize some key misconceptions.

- A Fed tightening cycle does not represent an immediate threat to stocks. Prof. Tim Duy, a leading Fed expert who is quite objective on markets, notes that stock price increases are quite common in this part of the Fed cycle. Put another way, the message from stocks and bonds might be correct in both cases.

![SP500 Stock Index](https://example.com/sp500-stock-index.png)

- The quiet trading range does not indicate “complacency” or a topping process. The highly-respected BCA Research sees a setup for an upside breakout. [http://www.valuewalk.com/2017/05/stock-market-break/](http://www.valuewalk.com/2017/05/stock-market-break/). I don’t know how to handicap this, but I do see a great disparity in coverage in these technical stories.

- Commodity prices, especially oil, are a poor indicator of demand and economic strength. Those believing the opposite simply ignore the supply side of the analysis. Credit Suisse explains.

- The VIX is a popular discussion theme, but not very helpful. The evidence for it as a leading indicator is weak. Few seem to know that the current levels of implied volatility (expectations of those in the options market) significantly exceed the recent past. Despite the low levels compared to times past, the readings are higher than we might expect from the data. Beware of making inferences from an indicator you do not completely understand.

- Objective valuation measures show solid potential for higher market prices. “Davidson” (via Todd Sullivan) offers multiple persuasive charts leading to this conclusion:

  Markets have a long history of rising with rising lending spreads. The current T-Bill/10yr Treasury rate spread, a proxy for lending spreads is currently 1.55% and rising after a brief
pull-back from Jan 2017 level of 2.00%. Markets peak when this rate spread falls to 0.2%. An excessively priced SP500 relative to the SP500 Value Investor Index with the rate spread falling to 0.2%-0.0% range is a signal that a market top and significant correction is at hand. There is no sign of this occurring anytime soon.

I expect economic expansion to continue for 3yrs-5yrs. Economic indicators tend to signal 24mos to 8mos ahead of market tops. I encourage investors to add to equity positions.

Market “messages” are many. Or perhaps none. Those believing in the wisdom of the market always seem to be chasing old prices and effects. The Chuck Carnevales, Ben Grahams, and Warren Buffetts of the world begin with a concept of value and view market prices as a deviation.

Even if you seek a message, the signals point in different directions. Pundits love discussing the market message. There is always something to say and no way to prove them wrong!