DJIA DELIBERATION

William "Chip" Corley *Q3-2018 Letter to Investors* *July 6, 2018*

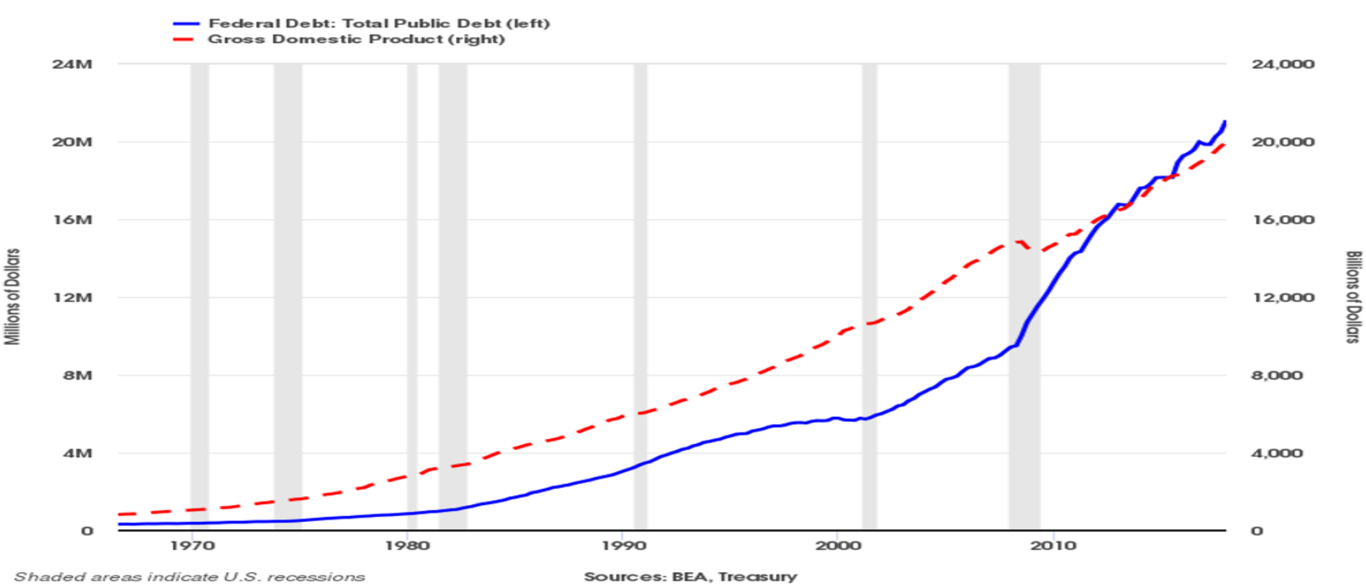
"You look at prices of stocks, real estate, anything in the short run, and the market is jacked up and ready to go. I don't think monetary policy the way it is conducted is sustainable over time. We are going to have to mean revert to a normal real rate of interest with a normal term premium that's existed for 250 years. We're going to have to get back to that, to sustainable fiscal policy, and that probably means the price of assets goes down in the very long run."

—Paul Tudor Jones (Legendary Global Macro Trader)

Word on the street surrounding current asset price valuation is exhilarating and nerve-racking. Opinions are a mixed bag; believers see the glass half-full, doubters see it half-empty, and realists observe the glass to be cracked and a leaking sieve. This 4th of July week was full of fun, frolic, and fireworks, as patrons of our great country enjoyed Independence Day. Come Monday, folks, for the most part, will be back to work and doing their best to arrive, survive, and thrive in hopes of a fulfilling life. Financial success is a collaborative effort; it takes personal initiative, energy, education, community, and government to make it all happen – no one can do it alone. What is the present state of the economy; is the economy better than ever, or is it a ruse?

Optimists cite the facts that unemployment and interest rates are historically low. Personal incomes, housing, U.S. stock markets, and job offerings are near record levels. The bullish story further reflects that inflation, as depicted by the Core-CPI at 2.2%, sits well below its long-term average. President Trump's trillion-dollar spending package, regulatory reforms, and personal and corporate tax cuts are now kicking into overdrive, which is bolstering corporate profits and consumer spending. In the past 12 months, home prices and global stocks have risen 7.1 and 8.5 percent respectively. For some, these are halcyon days with anticipation that the best is yet to come.

Skeptics taking the bearish side of this discussion see things noticeably less upbeat. They note that the Office of Management and Budget foresees the budget deficit rising to $832 billion in 2018, from $665 billion in 2017, and will approach $1 trillion in 2019. Total public debt has ballooned to $21 trillion; it now exceeds our nation's $20 trillion gross domestic output. The federal debt-to-GDP ratio is 106 percent and is expected to hit $27 trillion by 2023. The Dow Jones currently sports a 23x trailing twelve-month price-to-earnings ratio; this compares to the Dow's 16x historical P/E.



Perma-Bulls tout that stock valuations are forward-looking, and with corporate earnings revved up the Dow's P/E is projected to fall back in line to its 16x multiple. Bull markets are assumed to end when the market pulse and asset accumulation activity are euphoric. Stock markets usually top when animal spirits are high, consumer sentiment is unrestrained, speculation is rampant, and imprudence runs amok. It is at this point when the shoe drops and the pendulum reverses its course from bull-to-bear.

Perma-Bears hold fast that the economy is cyclical in nature; with the Federal Reserve rapidly raising interest rates, isn't it just a matter of time before this Goldilocks' scenario turns to dross by way of a recession? Bearish investors remember cogently that during the '08/'09 financial crisis the Fed loaded up its balance sheet by purchasing U.S. Treasuries and agency securities in the open market and artificially altering interest rates. The Fed's action sustained government spending and helped restore confidence, but at what cost? At some point, the U.S. dollar may be gravely affected by such behavior. Bear minded thinkers ponder how necessary fiscal restraint and tighter monetary policy may curtail or exacerbate the next economic downturn. How much longer does the United States expect foreign nations to continue funding America's deficit by purchasing treasury notes and bonds at such low yields if inflation picks up? Trade war anxiety and reliance on kind acts of other nations to do our bidding seems farfetched.

Q-3 marks the point on the calendar when stocks enter the summer sweats. Collectively, the months July, August, and September have earned the title for the worst quarter to be long stocks. During this sweltering period, the DJIA posted average gains of 0.07% compared to its all months average of .52%. Since 2000, the DJIA lost an average .59% across this three-month span. The month of July has generally been fair weathered for investors averaging 1.06 percent since the turn of the millennium.

Dow Jones Industrials Average Monthly Price Change Since 1900, 1945, 2000

DJIA	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
1900	0.77	(0.06)	0.85	1.20	(0.11)	0.25	1.33	0.86	(0.98)	0.26	0.96	1.28
1945	0.89	0.04	1.19	1.88	0.06	(0.23)	1.10	(0.26)	(0.79)	0.69	1.32	1.74
2000	(1.63)	(0.28)	1.69	1.95	(0.05)	(1.16)	1.06	(0.76)	(0.90)	1.57	1.80	1.28

According to the National Bureau of Economic Research (NBER), there have been 11 economic cycles since WWII averaging 69 months in duration. In June, the current business cycle celebrated its 9th birthday and is now in its 109th month. Sam Stovall, CFRA Chief Strategist, reminds market enthusiasts that, “Bull markets do not die of old age, they die of fear of recession.” Where do we go from here? Will the long-term secular bull of ‘09 continue its march onwards and upwards enriching intrepid shareholders; or, will rising interest be the upending of the second longest running bull market in Dow Jones history? It looks to me like this bull is getting tired, old, and ornery, and ready to buck off many a rider. Still and all, for the jockeys willing to hang in there and stomach the gyrations over the next several months, there is a fair chance for shareholders to be compensated by year’s end.

—William “Chip” Corley

Author of Financial Fitness: The Journey from Wall Street to Badwater 135