ECONOMIC HIGHLIGHTS

U.S. New Single-Family Home Sales were awful, at 553,000 units versus 625,000 units expected. The large difference was likely due to higher mortgage rates combined with limited supply. Durables Goods Orders came in at +0.5% for September, most of which was transportation equipment. U.S. Real GDP growth was 3.5% in an annualized basis for the third quarter of 2018. The GDP-Price Index was up at an annualized rate of 1.7%.

FIXED INCOME

The bond market is losing confidence in the Federal Reserve’s policy tightening projections after a punishing stretch for U.S. stocks. Traders pared wages on 2019 rate hikes last week as disappointing corporate earnings helped drag the S&P 500 10% lower from its peak. Bond yields are higher at one point Friday. Markets are now factoring in fewer than two quarter-point hikes for next year, compared with the three increases that policymakers project. Tanking inflation expectations suggest some investors already have Fed policy to the upside. Some are now considering equities, in line with the October rally, to be considerably higher at one point Friday. Wall Street believes the debate over a December Fed move may intensity. Eurodollar options activity suggests the same, with traders paying to protect themselves from a shock of a Fed pause at year-end. While others on Wall Street expect the central bank to proceed with its first hike next month, signs that liquidity is getting more scarce could get policymakers’ attention. “I can see another week like last week taking December hikes odds down to 50% because of the tightening in financial conditions,” said Priya Misra, head of global rates strategy at TD Securities. “One can only wish to pause and see if the economy can handle this tightening.” That would be the ‘question.’ Ten-year Treasuries are coming off their biggest rally since May. Yields sank 12 basis points last week to 3.06%, after setting a seven-year high of 3.26% earlier this month. There is risk ahead for bond bulls in October’s employment report which will be released on Friday. Confirmation of labor-market strength or evidence of quicker wage growth could reignite tightness in labor markets and drive up inflation expectations. There is also the Bloomberg survey of economists, up from a 2.8% increase in September. It would be the largest increase in three years. “If there is evidence that inflation expectations would be enough for the market to say, ‘This is why the Fed needs to keep hiking,’” Misra said. “Unless there is a massive drop in wages, the Fed’s path to least resistance will be to hike.” So far, Fed officials are still signaling a gradual path of rate increases, and despite the wobble in December hike odds, others still see it as a lock to happen. A continued crunch tighter in financial conditions could eventually merit a Fed pause, but it’s probably too early for that discussion.

CURRENT GROSS BONDS YIELDS

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<th>TREASURIES</th>
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CHANCE IN TREASURY YIELD CURVE

The recent sell-off continued last week, with U.S. stocks making new correction-low. The S&P 500 dropped a little more than -1% last week alone, pushing its year-to-date return to around +0.50%. Last week’s sell-off was broad in scope with Small Cap and Mid Cap stocks posting similar weekly declines. FactSet noted that more than 40% of the S&P 500 stocks are now down more than 20% from their 52-week highs.

EQUITY

INDEX RETURNS LAST WEEK YTD

Dow Jones Industrials -2.97% 1.85%
S&P 500 (Large Cap) -3.93% 0.98%
S&P 400 (Mid Cap) -4.10% -4.40%
Russell 2000 (Small Cap) -3.76% -2.42%
NASDAQ Composite -3.78% 4.69%
MSCI EAFE (International) -3.62% -10.88%
Shares Real Estate -11.11% -2.43%

Movin’ on to the other side of the market. The declines last week took out the 2700 support level we have been watching for some time on the S&P 500. That level now becomes the new area to be watching for support going forward. The S&P 500 ended the week at 2658, 21 days later.

The latest AAII Sentiment Survey shows optimism among individual investors has fallen to an unusually low level. The latest survey showed bullish sentiment at 28%, well below its historical average of 36%. Bearish sentiment jumped to 41% rising to a six-month high and well above its historical average of 39%. Historically, when sentiment readings reach more than one standard deviation below their historical averages it has mostly been followed by higher than average stock price shocks. Any exposure is for defensive position.

ASSET ALLOCATION

Below is a summary of our current stance on most asset classes:

- Cash: Holding as little as possible given the miniscule yields in money market instruments. Any exposure is for defensive positioning.
- Term-Intermediate Bonds: The current trading range of intermediate bonds warrants a neutral position with limited upside potential. Some opportunities still remain present in spread products.
- Commodity: Gold is a good hedge against inflation and uncertainty.
- International Equity: The risk reward ratio is lower than in the past, but emerging markets offer attractive valuations and diversification opportunities.
- Real Estate: Favorable.

Sources of statistical information are Bloomberg and Ned Davis Research.

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