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Outlook for 2019

By Thomas H. Kee Jr. President and CEO.

December 31, 2018

- This is a very opportunistic market – volatility is great.
- Downside moves can be as rewarding as upside moves.
- Our Liquidity Reports Foretold the beginning of these declines.
- Natural Indicators are working again because Stimulus is over.
- Expect the biggest single day point decline in Market history in 2019.
- Our outlook is bearish, but we are not one-sided.
- Our Proactive Strategies can work in both directions.
- Liquidity Drains will continue, and come from multiple places.
- The Markets will reprice themselves to proper valuations.
- Pension Plans will add to liquidity problems in Q1 2019.
- The Investment Rate will add to liquidity problems through 2023.
- The tolerance for risk in the market will continue to deteriorate.
- Buy and Hold Strategies are the worst place to be.
- Proactive Strategies like the Strategic Plan Strategy and Sentiment Table Strategy offered by Stock Traders Daily are excellent options that can work no matter what happens.

Price will remain a function of supply and demand, but demand will be a major problem.

Liquidity was ripped out of the Global Financial System on October 1, 2018, and the market tanked immediately thereafter, but it is not over! Review the declines in the SPX chart below.

These declines followed Special Reports issued recently in August 2018, June, February, and in 2017 too. The Special Reports told you to be ready for these declines, to adopt proactive strategies, and to NOT look back. For persons who did this, 2018 was a good year.

The reports also told you to move your 401K to the Cash Account! Protect it!

Exceptional Opportunities existed on the short side of the Market though.

The late 2018 declines brought the market down to the Fibonacci support levels that triggered our Dec. 26 Strong Buy Recommendation too; the market had its best 1-day point gain ever after this call to buy AAPL, QLD, UCO and SPY, and that was impressive. You can see this in the SPX chart above as well.

The 1000-point single day rally in the DOW was triggered by a natural indicator, and some people are calling this the best trading alert in History, but this is not a surprise. We'll see more of that, expect our NATURAL INDICATORS to continue to work in 2019, and beyond, as they did prior to Stimulus, but moderate your expectations for immediate single day moves like that of course.

Still, don't count them out. Liquidity drains can result in more drastic moves in both directions, so we could easily see a biggest single day point gain again, and a biggest single day point decline in 2019 too.

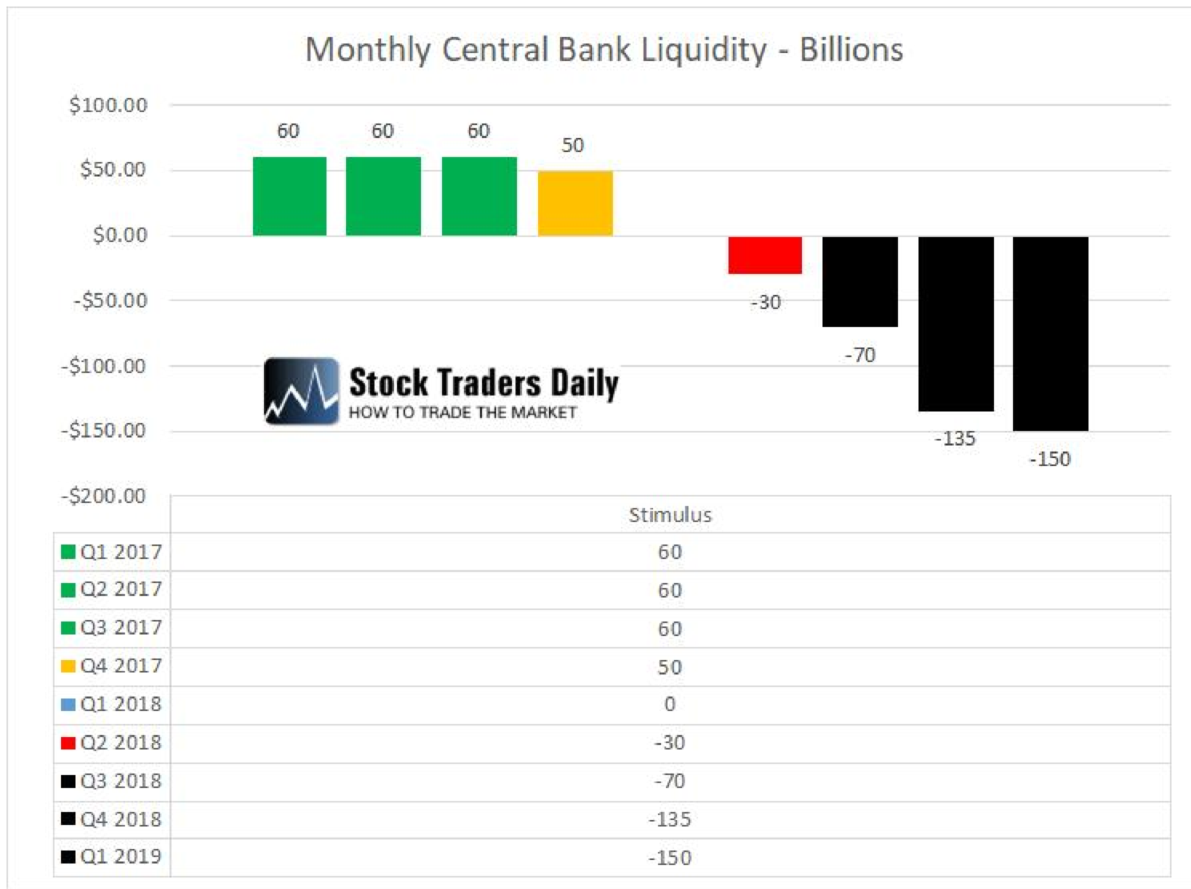
> *Important: on Dec 31 Our Sentiment Table Strategy secured 7.2% from the Dec 26 2018 Strong Buy Signal, a few days after the trigger, because the market became overbought. The Strategy also turned short at that time; we do not know the results of that yet, but that is how opportunity will be defined in this market! Use it to the best of your advantage!*

Admittedly, it is very nice to see indicators that have been almost forgotten in recent years start to work again. Stimulus compromised the effectiveness of natural indicators in recent years, a sign that the influence from Central Banks was not natural, and now that Stimulus is over these natural indicators are working again. Global Stimulus will officially end on January 1, 2019, but liquidity drains are already double the monthly stimulus from years ago (see graphic below), and volatility is already here. The official end of stimulus will rip another $15B from Global Liquidity monthly, and allow the markets to act even more naturally than they are already.

That's beautiful to me. FINALLY!

Although we saw initial signs of this earlier in 2018 too, the 1000-point rally solidified that a change has come, and our Natural Indicators are working.

The time to embrace natural indicators is now!



Think carefully about the discussion above as you continue to read this outlook. We made a tremendous amount of money buying stocks and stock market ETFs at the end of 2018, yet our outlook is extremely bearish. That's because we embrace the market on both sides, not just one. In volatile times, the markets surge sometimes too, often after they decline aggressively, and our job is to respect the natural indicators that tell us where those turning points will be. We like to ride the market down, and then pivot and ride the market up, or vice-versa. Respecting these pivot points will be one of the keys to success in 2019, and BUY and Hold strategies will likely be the worst at the same time.

Respect the indicators, but do not ignore **THE MACRO PICTURE**

A process that started in Q4 2017 and that is reflected in our series of Special Reports on Liquidity, Central banks cut global liquidity gradually in 2018 at first to test how the markets would handle it, and then liquidity drains doubled in Q4 2018; from there, the market began to act exactly like we expected.

Volatility levels skyrocketed, the markets started to care about news and events again, and major market declines took place regularly. This all happened because less money was chasing stocks, and at the same time valuation levels were higher than in any other bull market in history. Think about that. There has never been a more expensive Bull Market than the one that just ended, Ever!

Risks have never been higher before from a liquidity perspective, and that was just the most expensive bull market in history from a Price/Earnings perspective. What an awful time to invest in Buy and Hold!

Rationale for a Market Crash:

This is NOT going to change immediately, risks are going to stay elevated, and with that risk tolerances will decline, and there's the rationale for a market crash; that's enough. Valuations will continue to be questioned, and the Markets will reprice themselves to fairer valuations.

All that is required for a crash is a change in risk tolerance, and that seems assured.

In 2019 the declines may get much worse, because when markets act like this people start to ask themselves why they are willing to assume so much risk, and that has a compounding influence. This will be apparent again in Q1, 2019, after Pension Funds get their first big negative quarterly report in years. The average Q4 2018 statement will show a 14% loss. They won't like that.

On 12.31.18, when this was written, the quarterly reports for 2018 had not been bad so far. Q4, however, will be, and when pension funds meet important questions will be asked. They have not been asking many questions yet, because everything has been good until this report, but it suddenly changed, so this can mark a tangible shift in risk perception.

Another way of thinking about this, the declines that have happened so far may very well be due to faster money, while the elephants in the room have yet to get statements, and their boards are yet to meet, so they are yet to make decisions. Expecting these big players to suddenly sell everything is absurd, but they could reign in their willingness to invest aggressively after they see what happened to them in Q4 2018 and in December alone.

For example, a pension plan may decide to increase cash positions, and re-direct new inflows from investment accounts to cash accounts for a while. This would further remove an important source of demand from the market. Those inflows are import because of their consistency, so if that consistency changes it will have an impact.

Overall, a decline in risk tolerance is usually directly reflected in the PE multiple for the Market, and that has been true so far, but it will get worse. The Q4 2018 Statements could cause additional liquidity problems. We should be ready for that.

Others may suggest that the declines that have happened already are adequate and there's no reason for additional decline; the PE on the SPX was 25x when our liquidity reports were issued, and that has now declined to about 20x (12.31.18). A 20% multiple contraction sounds big, but historical norms are 14.5x, so it's still rich. There is still room to retrace on that basis, but there's something else to consider.

The Investment Rate:

Markets tend to overshoot and undershoot long term trends. We can see this VERY clearly in the charts dating back to 1900, and especially during the down cycles in The Investment Rate. Using the chart below, look back at the action between 1928 – 1938 (Great Depression), and 1969 – 1981 (Stagflation). These were the only two other times in history where natural demand levels fell according to The Investment Rate, and we are in that exact same position now, but Stimulus masked everything, so investors and institutions became lazy; many have forgotten about this, or simply are not aware.

They will be forced to change! They will care again!

Natural Indicators are as certain as Death and Taxes, and there is no natural indicator more important than The Investment Rate. This derivative demographic analysis measures the rate of change in the amount of NEW money available to be invested into stocks, bonds, and real estate, annually, dating back to 1900 and extending beyond 2060. We consider it the most accurate leading longer term indicator of stock market and economic conditions; it has been able to define all major market cycles, both up and down in advance since 1900, but that seemed to change with stimulus. Now that stimulus is over, we expect that to prevail again, and other Natural indicators already have.

The Investment Rate is rooted in ingrained societal norms from decades ago, it is natural because it is based on the way people invest their money over time, and it supports the thesis that price is a function of supply and demand. The Investment Rate is a demand-side indicator.

Long Term Investment Rate Chart:

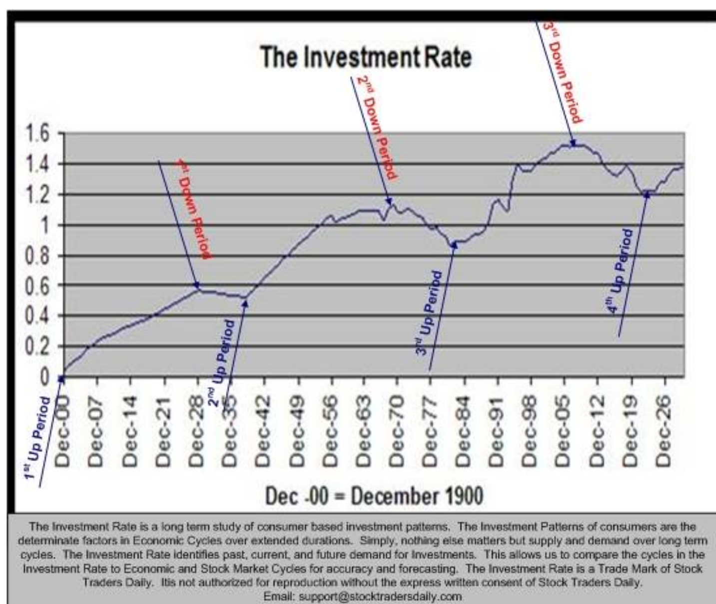
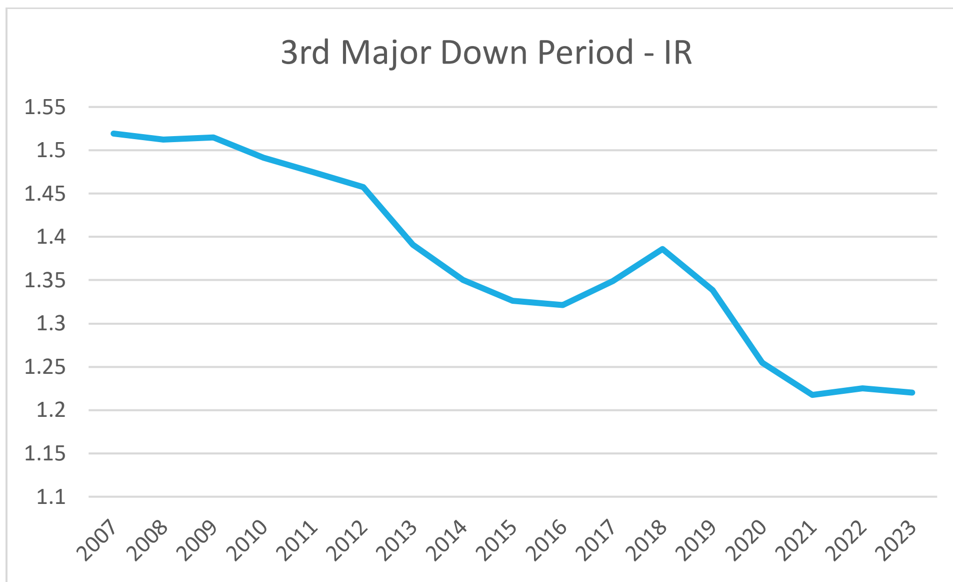


Chart Takeaways:

- Natural demand is Declining aggressively and has been since 2007.
- December 2007 marked the beginning of the third down period in US History.
- Weakness started, then was masked by Stimulus for years; that changed in 2018.
- The end of this down period will be 2023. There's plenty of time left.

Interestingly, the conclusions that the Investment Rate made leading up to December 2007, which was the beginning of the third major down period in US History, are relevant again. Natural Demand Levels are growing at much slower rates, they have been since 2007, and these declines are set to accelerate in 2019 as well. In this chart you can see the changes in the Investment Rate (IR) between 2007 – 2023.

Look at the acceleration between 2018 – 2021 as well:



The Chart above measures the Investment Rate during this third major down period in US History. In prior down periods (Stagflation and the Great Depression) the markets reacted negatively along with declines in natural demand levels like this, and this third one started that way too, but when stimulus kicked in this natural derivative demographic demand-side deterioration proven by the IR was masked.

Now that stimulus is over, the natural demand levels will prevail again, and natural demand growth is expected to crater by an additional 20% before this is over. Lower demand growth translates into slower overall economic growth, and that typically influences lower PE Multiples too, but there is something else to consider that demonstrates the compounding influence.

Because stimulus created an unnatural demand for global assets, the starting point to measure the drawdown in demand, and thus liquidity, is not adequately referenced in the chart above. The chart above shows the NATURAL DECLINES in demand, and assumes the starting point is equivalent with 2018 Natural Levels too, but that's not the case. The starting point is significantly higher, skewed that way because of stimulus, and the resulting decline in demand will be much greater than 20% as this process unfolds, as a result. A reversion to the mean, natural demand levels, has already started, and it will continue, and we should expect global asset demand to crater even more in the years ahead.

The three major Liquidity Drains in 2019:

1. Central Bank Liquidity Drains.
2. Declines in Investor Risk Tolerances.
3. The Reversion to the IR – demand levels.

Stimulus is not there to support asset prices in the face of declining natural demand levels, and natural demand levels will prevail as they have since inception. This is as sure as death and taxes.

When we remove fabricated demand, natural demand prevails, and natural demand levels are SUBSTANTIALLY LOWER than where demand levels still are, even after the late 2018 pullback.

- Our outlook for 2019 is extremely bearish.
- We are braced for a market crash.
- Buy and Hold is Dead

What to do in 2019:

Strategies such as The Sentiment Table and Strategic Plan Strategies offered by Stock Traders Daily should be used in this market environment, and for the foreseeable future. Invest in Strategies, not in the Stock Market, and 2019 could be a great year.

Once the Market properly reprices itself, we may begin to allocate money to 'long term hold' positions again, but the time for that is FAR AWAY. In 2019 investing in Strategies that use our Natural Indicators that have already begun to work again will be the best idea, and that should provide exceptional returns, but the most important thing for most people will be to adequately protect assets.

Respect what the Investment Rate says, respect the ongoing liquidity concerns, respect the valuation risks and recognize that no material catastrophic event needs to happen for a market crash to come. We do not need a credit crisis. Price is a function of supply and demand, and demand levels have cratered and will continue to fall aggressively, and prices can adjust down without any catastrophic event, but if there is anything like that we will end up getting the worst single day point decline in history in 2019. The action can be that ugly, or should I say, that attractive.

At the end of the day, these are very opportunistic times. Declines are just as valuable as increases to proactive strategies like ours.

BRING IT ON!!!

We are ready, and there's no reason for anyone who is currently engaged in our proven proactive strategies to change anything. Invest in strategies, let them work, and embrace these conditions.