Weekly Market Review

***e*Research Corporation** is pleased to provide a review of the markets by Eddy Elfenbein of **Crossing Wall Street**.

Mr. Elfenbein introduces his commentary with the following quote from Ernest Hemingway:

"“How did you go bankrupt?” “Two ways. Gradually, then suddenly.” — Ernest Hemingway, The Sun Also Rises”

Read Mr. Elfenbein’s analysis and market comments on the following pages.

Information about **Eddy Elfenbein** and **Crossing Wall Street** is provided at the end of this article. You can also learn about **Crossing Wall Street** by going to its blog website at: http://www.crossingwallstreet.com/.

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Contributing Analyst

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Crossing Wall Street: Weekly Market Review

by Eddy Elfenbein

BW: We have taken only an extract of Mr. Elfenbein's latest weekly article. If you wish to read the entire article, which includes stocks in his recommended portfolio, there is a link provided below.

After nine-and-a-half years, one of the longest bull markets in history is on life-support. What started out as a minor down-turn has, since December, turned into a major sell-off. Ever since President Trump referred to himself as "Tariff Man," the Dow has plunged nearly 3,000 points.

Of course, no down-turn has a single cause, and the Federal Reserve's fingerprints are clearly visible. This week, the Fed raised interest rates yet again, and it sees more hikes coming next year. The market reacted swiftly and negatively.

The numbers are remarkable. On Thursday, the S&P 500 closed at its lowest level in 15 months. In the last 12 trading sessions, the S&P 500 has lost 11.6%. The details are even uglier. Within the index, 423 stocks are now trading below their 200-day moving average. On Thursday, new lows beat new highs 175-0.

Never fear. In this week's issue, I will walk you through the mess and explain what to do now.

The Fed Raises Rates and the Market Raises Hell

The Federal Reserve met again this week and, for the fourth time this year, the central bank raised interest rates. The target for the Fed funds rate is now 2.25% to 2.50%. As I have said before, I think raising rates now is a mistake. It is true, the economy is getting better, but I still have not seen the normal pressures that signal an over-heating economy.

The facts are pretty straightforward. Inflation is low. The U.S. dollar is strong. The Canadian dollar just hit a new low. Commodity prices are down. The price of crude just fell to a 15-month low. Housing is having a tough year, and some markets are struggling. But, for some reason, the Federal Reserve has been determined to raise interest rates. Some folks speculate that they are trying to prove their independence from a critical White House.

Perhaps.

But what really spooked the market are the Fed’s apparent plans for even more hikes next year. The Fed’s policy statement noted that, “the labor market has continued to strengthen and that economic activity has been rising at a strong rate.” The statement also said that “some further gradual increases” are needed. In other words, they ain’t done!

Along with the policy statement, the Fed released its economic projections for the next few years. The Fed members see two more increases next year. I think that Is way off base. In fact, if I were a Fed member (a big if), I would be leaning towards zero hikes for the next six months. Let workers see more gains. That Is more revenue for business.

The Fed is actually moving in the right direction. The forecast from September called for three hikes next year. One member was on record calling for five hikes! So, while the Fed is moving in the right direction, they still have a lot more room to go. I like to look at the futures market to see what the serious money thinks, and they do not see any rate hikes coming next year. (To be precise, it is almost 50-50 on one hike next December.) In fact, the futures think there is a very, very slight chance of a rate *cut* sometime next year.

Let me explain why I am so concerned about rising interest rates from a stock-market perspective. Short-term interest rates are largely determined by the Fed. That, in turn, impacts long-term rates. That, in turn, influences stock valuations. If bond yields fall, then P/E ratios can go higher. But if yields rise, then P/E ratios will drop. The relationship is hardly perfect, but it is good enough for our purposes.

Right now, earnings, the E in the P/E ratio, are growing quite nicely. However, rising yields are forcing the P/E ratio down. The S&P 500 is currently going for about 14 times next year’s earnings. That is not expensive. A year ago, Moody’s Baa Bond Index was yielding 4.2%. That is up to 5.0% today. As a result, prices have shifted according to the new competition.

If someone can get 5% from a fairly generic corporate bond, why should he or she bother with stocks? As a result, the price of stocks has gone down to entice investors back. So what is happening is that the market is shifting towards a more defensive posture. In simple terms, conservative stuff like bonds and defensive stocks are holding up well, while cyclical stocks (industrials, energy, banks) are suffering.

How much longer will this last? Beats me, but I will say that sell-offs usually end before anyone realizes it.

Since its closing high three months ago, the S&P 500 has lost 15.8%. Traditionally, a 20% drop is considered a bear market. We may get there soon.

In the short-term, the key for us to watch is the 200-day moving average. Whenever we are below the 200-DMA, as we are now (by more than 10%), you know that the seas will be rough. Expect more volatility. We will get jerked higher and lower a lot but, once we clear the 200-DMA, things will get a lot calmer.

What to Do Now

The first and most important thing to do is not panic. In fact, that is so important that I will make it the first and the second thing to do. Remember Warren Buffett's dictum: "Be fearful when others are greedy. Be greedy when others are fearful." Right now, there is a lot of fear. I do not advocate greed, but I do support disciplined buying.

I also don't want you to concern yourself about waiting for the absolute bottom. In retrospect, people think of "the low" as a big event that…happens. In reality, no one realizes it at the time, and it usually happens a lot faster than you think. You can be sure that there will still be people predicting the next big leg down.

In 2008, a major low came on November 20. Although this was not the absolute low, it was a good time to buy. At the time, people were massively freaked out. The VIX was at 80. That is crazy, but the prices were good. Right now, investors should focus on high-quality stocks going for discounted prices.

Next week, the stock market will close at 1 p.m. ET on Monday, and then be closed all day on Tuesday, Christmas Day. There is not much expected in the way of economic news. On Thursday, we will get jobless claims, housing starts, and consumer confidence. Then, on Friday, the home-sales report is due out.

Be sure to keep checking the blog for daily updates, and I will have more market analysis for you in the next issue of *CWS Market Review*!.

- Eddy

BW: In the rest of the newsletter, Eddy reviews the earnings announcements of the companies on his Buy List. You can read about them and the entire article by clicking on the following link. Also, he will be issuing his 2019 Buy List portfolio on Tuesday.

http://www.crossingwallstreet.com/archives/2018/12/cws-market-review-december-21-2018.html

Named by CNN/Money as the best buy-and-hold blogger, Eddy Elfenbein is the editor of Crossing Wall Street. His free Buy List has beaten the S&P 500 for the last six years in a row. This email was sent by Eddy Elfenbein through Crossing Wall Street.

BW: Information on Eddy Elfenbein and Crossing Wall Street follows on the next page.

ABOUT THE AUTHOR

Welcome to Crossing Wall Street

I started this Web site to help individual investors. I have to admit that I *love* the stock market. I think I must be an addict. In my opinion, the stock market is one of the greatest inventions in history. The stock market is simply the most consistently successful way to make money over the long term. Even after the financial crisis, stocks have still beaten every asset category over the long haul—bonds, commodities and real estate.

While the stock market may bounce around from day to day, and even month to month, the long-term trend has always been higher. Over the last 35 years, stocks have gone up 35-fold. And since the end of World War II, the stock market is up an amazing 120,000%. I wish I had been around! That was the beginning of an American financial revolution. Today, weare at the beginning of a *global* financial revolution. That is why I think the next 70 years will be even better.

The key to doing well on Wall Street is actually very simple: Buy and hold shares of outstanding companies. But too many investors never learn this valuable lesson. Or if they do learn it, they learn it the *hard* way. That is where I come in. I want to help investors avoid the mistakes that separate successful investors from those who always find themselves spinning their wheels.

There are lots of pitfalls on Wall Street. From shady companies that are more popular than they are profitable to a mutual fund industry that is more interested in its fees than serving investors. Todayis investors must be careful.

At Crossing Wall Street, I give investors my free and unbiased view of the market. I probably analyze dozens of companies every week. I am always looking over income statements and balance sheets. I've spent several years collecting my list of the best companies to own. This is my current Buy List. I've included a description of each company and its current share price. These are the ones that I make the most effort to follow on the site, but please feel free to ask me my opinion on any stock. I don't receive compensation from any of the stocks I recommend. Also, I don't "short" any of the stocks I criticize. At any time, I may own the companies on my Buy List. All of the information on this site is free and unbiased. I also have a section for Frequently Asked Questions that will help you learn more about Crossing Wall Street.

Please feel free to e-mail me. I enjoy getting feedback from investors. I am happy to give you my opinion on any stock or investing in general. I should warn you that I cannot give out personal portfolio advice, but all other topics are fair game. You can also check out some of my favorite links.

- Eddy Elfenbein

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