Good Afternoon to All Clients and Guests

I am on my way out the door for a two week vacation so this will be brief and to the point.

The Federal Reserve went ahead this week and cut rates by 0.25% (the first in almost 11 years) and rolled back the Quantitative Tightening (QT) program.

The markets responded with serial 300 point DOW down days and a negative week for the equity markets!!

This negative response is very unusual as most often rejoicing markets zoom in those early rate cutting days as with cheaper lending/borrowing rates it implies more consumer spending (e.g. housing, cars, trucks, retail) and a "soft landing" outcome (vs recession).

But there are a few unnerving issues for the markets such as the Fed stating this was only a "mid-cycle adjustment to policy" implying that there are fewer or perhaps no more rate cuts near term….YIKES!!

Both the equity and bond markets believe that this is a mistake and are telling us that the global economy is very weak and for this party to continue we need lots of FED help with much lower rates.

The equity markets hope if we see more rate cuts than we can entice more lending-spending and a soft landing whereas the Bond market is telling me that it is too late for this cycle and best to "get outta Dodge"!

I expect to see many references to "pushing on a string" going forward wrt to the Fed hoping to help the weakening economy and consumer with lower rates. BUT the fact is that we **already** have low rates and consumers, banks and CEOs have used these lower rates to consume and rack up +++ debt..

The Fed can pull the economy (or string) back if things are too hot by raising rates BUT CAN NOT push banks (or push on a string) to lend, CEOs to spend or consumer too borrow more if they have already over spent or see a slowing economy regardless to what the rates are!!

My take is that we have been in a global slow down for 19 months and It is therefore prudent to remain in a defensive position with lots of cash and "cash substitute" especially as we wade through the two worst investing months of the year August and September…

Here are some of the reasons why I remain defensive:

#1 TRADE CONFLICT IS A BIG RISK

-my belief has always been that China will wait Trump out…there is NO reason for them not to!! Trump has to answer to the voters and CEOs whereas (in the short run) China can ignore/suppress this noise

-this ongoing trade conflict is killing global trade and nervous CEOs are afraid to commit $ to CapEx or to new construction etc. and is reflected in the weak commodity prices

#2 THE GLOBAL ECONOMY CONTINUES TO WEAKEN

-the JP Morgan Global manufacturing PMI has been in decline since Jan 2018 and is now officially below 50 which tells me we have a global recession on our hands!!

-this is supported by the OECD Leading Indicator which has now declined for 17 straight months and is at the lowest level in a decade!!

-as you would expect global trade is the weakest in a decade

-Europe, China, Australia, UK and now the USA are all either in a recession or very close!!

-China has come to the rescue in past global recessions with massive spend programs….but this time I doubt it?

(Note the “irony” that the US Equity markets are at all-time highs despite this global weakness and this “Disconnect Theory” is based on a combination of CEO Financial Engineering schemes (share buy backs) and the hope of the “Powell Put”…I cannot see this ending well???)

#3 THE USA IS ALSO WEAKENING AND NEAR A RECESSION

-the New York Fed has a “Recession Probability Model” and whenever it has reached 30% over the last 70 years we have seen a recession—NOTE—the current level is 32.9%...equity buyer BEWARE!!

-The CASS Freight Index peaked Jan 2018 and as of Dec 2018 has turned negative “signaling an economic contraction” according to Mr. Cass

-the IHS Markit PMI for the US manufacturing sector is now at the lowest level since Sept 2009….at 50.4 and so it is just a hair above contraction levels….

-The Conference Board Leading Economic Indicator stalled in Sept. 2018 and its 6 month growth rate is now at zero (D Rosenberg)

-Housing starts and permits remain extremely weak DESPIT lower mortgage rates…housing is a very early cycle indicator and reveals things are not good

-we have also seen a recent surge in auto loan delinquencies which means less lending by banks

-recent data show that small buss companies in the US are not doing well and these are the ones that do most of the new hiring

#4 RATE CUTS and HISTORY

-this was the first rate cut in almost 11 years!!

-since 1950 we have had 19 easing cycles and 50% of the time we see a recession in short order…but the last 3 rate cut cycles we saw a recession start abruptly within 3 months of the first rate cut (Zero Hedge)

-typically the first rate cut occurs about 4 months AFTER a peak in the S&P 500 and usually the markets are already down -12%....not this time however ---tis rare to get a rate cut when markets at a peak so I expect at least a -12% decline over the next few weeks….??

-Fed Powell stated that this was a “mid-cycle adjustment to policy” and neither the bond or equity markets believe this is accurate and that is why both have tumbled this week

-My view is that we are in an ongoing economic cycle slow down (have been since Jan 2018) and rate cuts will NOT help our structural problems…we do not need lower rates as if we did than housing, autos, construction would have picked up over the last 4 months

#5 OTHER SELECTIVE POINTS

-Year 4 of the Presidential Cycle begins soon and it is a weak year over uncertainty and I think even more so this year…

-August –Sept are the two weakest stock months and after the surge this year (Year 3 is always the best year) we can expect some give back??

-Beyond Meat is the biggest bubble these days with a P/S of 118 and forward P/E of 4000---only buy it to trade it!!!

-The "Structural Problems" remain to be resolved for this cycle such as demographics, massive debt and technology—neat point—in 2009 there were 1790 employees for every $1B market cap and today there are ONLY 656 according to Mauldin!!! Tech has made the top 1% VERY rich but has killed the bottom 90%...hence the rise in populism and this is not going away

-suspect we will see significant market volatility as we get closer to the 2020 US election….so at best flat market returns from here

CONCLUSION- THEY ARE "PUSHING ON A STRING"!!!

The current global/US economic cycle slowdown has been in play now for 19 months.

This shows no sign of abating and stocks "typically" do VERY poorly during these down cycles.

Thus far the S&P is up about +4% over this period BUT typically we see double digit declines!!

I still expect to see these declines as the full cycle plays out—perhaps over August-September?

If we see a recession than the losses are much higher with the average loss being -35%.

I expect larger losses than average if we get a recession simply based on the current froth and the many structural problems at play. I also note that with the last two recessions we had 50% losses!!

It is too late for lower interest rates to save this cycle—the damage has been done re excessive lending/borrowing and debt! There is no Pent up Demand left and so lowering rates will be akin to "pushing on a string".

Companies will only borrow and expand if the economy is strong…lower rates will not solve a weak economy if pent up demand is past tense and especially if there is a high level of uncertainty such as Presidential guidance and trade confusion.

We will continue with our "Defensive Investing Strategy" that has been implemented for all clients and has allowed for good returns over the last year DESPITE our defensive posturing!

I thank you all for your patience here!!!!!!!

I hope you all have a great summer!!! Off to NFLD for a week and then TO for a week visiting family!!