BILLS ASSET MANAGEMENT

BAM MARKET NOTE

NOVEMBER 9, 2018

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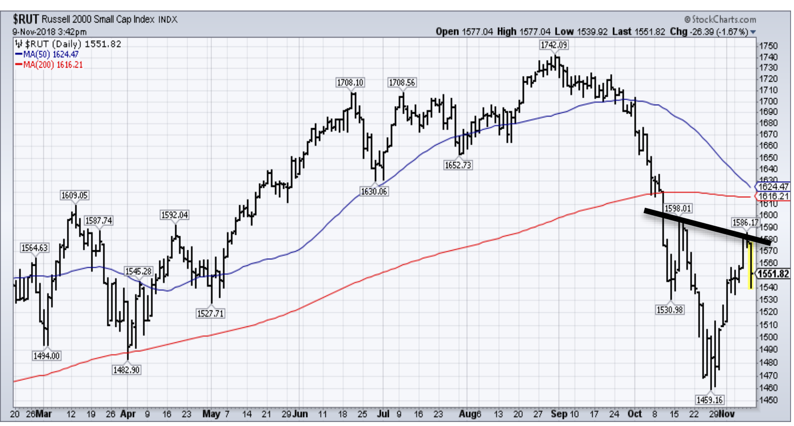
The markets have staged an impressive rally over the last 2 weeks and have recovered about half of the October losses. As I write this, the S&P is down 1% but well off its lows. The widely followed index traded down to its 200 day moving average before bouncing. As mentioned last week there was one unfilled gap and this week we had another one (see red circles). It is typical (but not always) that gaps are filled before a new trend begins. This week's gap was partially filled today which leads us to believe that the market will decline at least enough to completely fill the gap. We are in much better shape than a couple of weeks ago but not out of the woods yet.



The Russell 2000 remains much weaker than its big brother indices. While the S&P and Nasdaq both rose above their 200 day moving averages with the recent surge, the Russell remains considerably below its 200 day moving average. We would like to see small caps and technology lead this rally before getting too excited about its sustainability. The relationship between up-legs and down-legs is a key tenet of technical analysis. Until we see higher highs and higher lows in the current rally, it will remain suspect.

Our Point

The Fed came into focus a little this week as they released their rate decision yesterday. Rates were held pat and little was changed in its forward looking guidance; the economy is strong and rate increases will continue at a measured pace. Wall Street was little surprised. Absent a big market/economic surprise, It is all but certain that the Fed will raise rates when they convene again in December. Today's PPI came in a little higher than expected raising the specter of inflation which seemed to add a little fuel to the decline already in progress. However, as the week comes to a close, the markets are trying to stage a late day rally to pare the losses. We'll see how we close. The mid-term elections came in much as anticipated – Democrats take the House and Republicans hold the Senate. However, the removal of one market uncertainty was cause for celebration as the markets rallied on the results. With a split-government we are likely to have 2 years of gridlock which, history tells us, is good for the markets. When Washington fails to enact major legislation the degree of uncertainty decreases. The fourth quarter is almost always among the strongest of the year but we will probably have to go through another week or two or three of repair before any sustainable rally materializes. Of course, we could be wrong and, as always, will watch the charts for clues on the health of the markets. We made no changes to our portfolios this week and will continue to watch for confirmation that the current rally has legs. Until such time, we are sitting out the volatility. We remain relatively bullish over the next month or two. Get out your coats and have a great weekend.