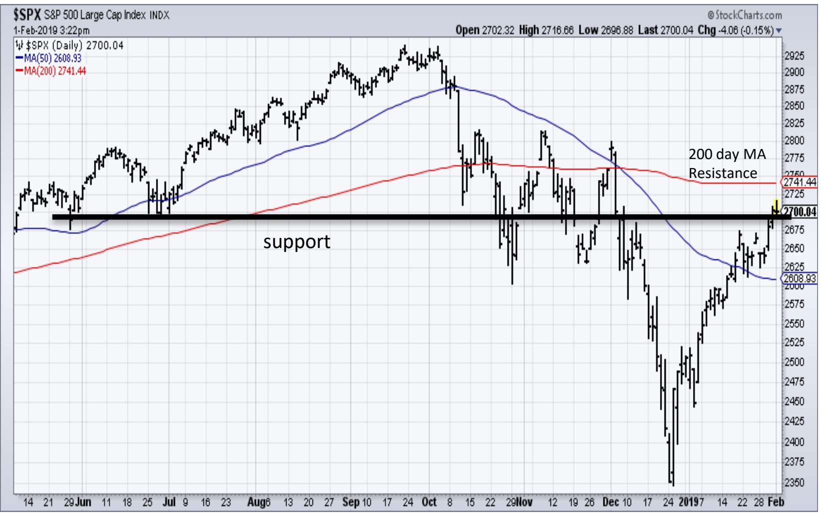
BILLS ASSET MANAGEMENT

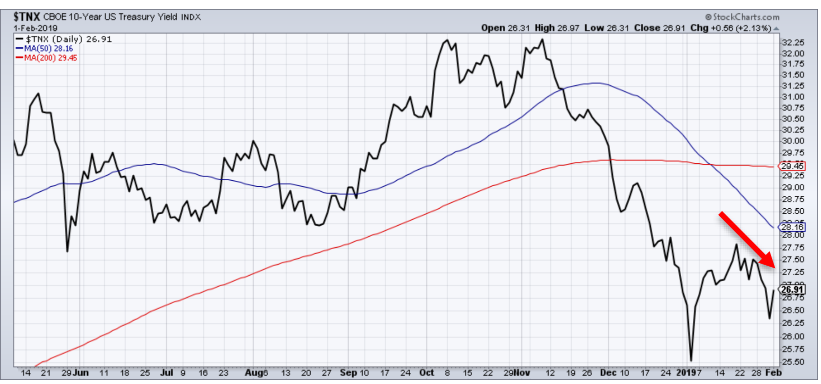
BAM MARKET NOTE

FEBRUARY 1, 2019

SAM BILLS (865) 525-1329
BO BILLS (615) 371-5928



After the worst December performance since the Great Depression, the market has turned in one of the best January's in recent memory. The rise has continued unabated with virtually no pullbacks or rest to allow those that were out of the market in December a reasonable opportunity to move back into the markets. The market has been fueled by optimism that a trade deal with China is moving in the right direction and, more importantly, a suddenly dovish Fed sounding like there are no more rate hikes in 2019. 6 weeks ago the Fed was contemplating 2-3 rate hikes in 2019. It has been a remarkable 180 degree turn by the Fed that caught many off guard – us included.



Speaking of interest rates, the ten-year treasury has been acting strangely over the last 2 weeks. While the market was moving higher, interest rates were declining strongly. The ten-year treasury rate increased by 9% in early January and was in step with the market. However, since January 18th it has declined over 5%. It is catching a bid today so it may just be a blip and the result of the more dovish Fed. However, it is worth watching as bond traders often see weakness before stock traders.

Our Point

By any measure January was a good month for the major averages. The rise upward began the day after Christmas and has barely skipped a beat over the ensuing month. Despite the surge, the S&P remains 8% below where it closed in September of last year illustrating the depth of the decline in the 4th quarter of 2018. The landscape has changed since late 2018 with a Fed now signaling a much more dovish posture. Chairman Powell's abrupt change points to how political this position is despite its charge of being independent. There is no doubt that whispers from Wall Street and tweets from the White House had their desired effect as the Fed changed its course from hawkish to dovish in a matter of weeks with nothing in between but a stock market correction many would call normal and needed. This is not to say that what the Fed did (or signaled what it might do) is wrong policy but the manner in which it was carried out certainly raises questions. The change also puts the Fed in another tricky position. If today's job report is any indication, the economy is stronger than the Fed seemed to indicate in its most recent meeting. Should the economy strengthen over the coming months, the Fed will have to backtrack again. Not only did the Fed become more dovish on interest rate hikes but it also pulled back on its language regarding its reduction of its balance sheet. Perhaps the balance sheet discussion is even more important than interest rates as it has an equal or greater effect on the liquidity in the economy and was not anticipated by most Fed watchers. Time will tell where the Fed goes from here but a friendly Fed does change the environment we were in just a month ago. Last January we had a similar market where we had a strong start to the year. If you remember, the strong January was followed by a very swift and painful decline in February. While we have no idea what February of 2019 holds, the market is overbought and a pullback of some magnitude would not be unexpected over the next week or two. We made a few small adjustments to our portfolios but will wait for a pullback to make our next significant move. It's Superbowl weekend and I don't like either team so I can't win or lose – just hoping for a good game and some tasty snacks. We hope your team wins and that you enjoy the game.