

BILLS ASSET MANAGEMENT
BAM MARKET NOTE
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It's been another ugly week for the markets. The S&P has fallen another 1% this week and is now over 5% below its January highs. While the decline itself is not overly significant, the technical damage in the charts is mounting. The failure for the markets to hold support at the 200-day moving average is significant. The support level we are sitting on today is also very important as it marks the lows of last October and November. A break here would likely lead to another 2% decline down to the next support at 6400. The longer we stay below the 200-day moving average, the greater the risk of a more serious decline. Risk is elevated and extreme caution is warranted.



The behavior of gold has been very interesting of late. After reaching a high in late January, the gold metal has fallen nearly 18%. In times of war, gold often acts as a hedge and a flight to safety. That is not happening currently. While some of the decline may just be profit taking after the parabolic rise since last September, the recent weakness may indicate that investors are more concerned with inflation and Fed rate policy than the war itself. The chart is worth monitoring as a rally in gold may indicate a shift from inflation fears to a more systemic risk to the US economy.

Our Point

From an historical standpoint, a 5% decline in the markets is not unusual nor is it necessarily cause for concern. However, this 5% decline does feel a bit more concerning. The technical damage done to the markets is becoming significant. With the damage done, V bottoms are less common. More likely, at best, we are in for a month or two of churning where the markets try to find a bottom. At worst, the decline is the start of a much broader and painful decline. The continued conflict with Iran does not appear to have a quick resolution – or at least one that accomplishes the stated goals. As such, it appears that the 2-3 week war could go on for 2-3 months. However, regardless of what you think of President Trump, he is a pragmatist and a politician. The upside to a positive resolution is significant. However, an extended or expanded war will turn the market down even further. Our belief is that with gas prices rising, inflation rearing its head and the mid-terms looming, a victory or at least a palatable solution will be reached. Speaking of inflation, the Fed remains in a very difficult situation that keeps getting harder. The Fed has dual mandates – control inflation and support employment/economic growth. Those mandates are now colliding. The rise in oil prices is creating inflation concerns but not due to increased demand (growth). The threat of inflation is curtailing the Fed from cutting rates. However, the rise in oil prices is also causing economic growth concerns pushing the Fed to consider lowering rates. The conflicting signals won't be resolved until there is more clarity in the Middle East. The market remains headline driven. With the market becoming oversold, good news could spark a significant bounce. However, with many already thinking about selling, bad news could lead to a larger sell-off. Nobody knows which way this market will go in the near-term. Accordingly, we have begun to get a little more defensive as we sold a couple of equity positions this week. More will follow on continued weakness. We are watching things closely. It looks to be a gorgeous and warm first weekend of spring. The Fed isn't the only one with a dual mandate dilemma – watch March Madness basketball or get out and enjoy the weather. I suspect there will be lots of both for me. Enjoy your weekend wherever it finds you.