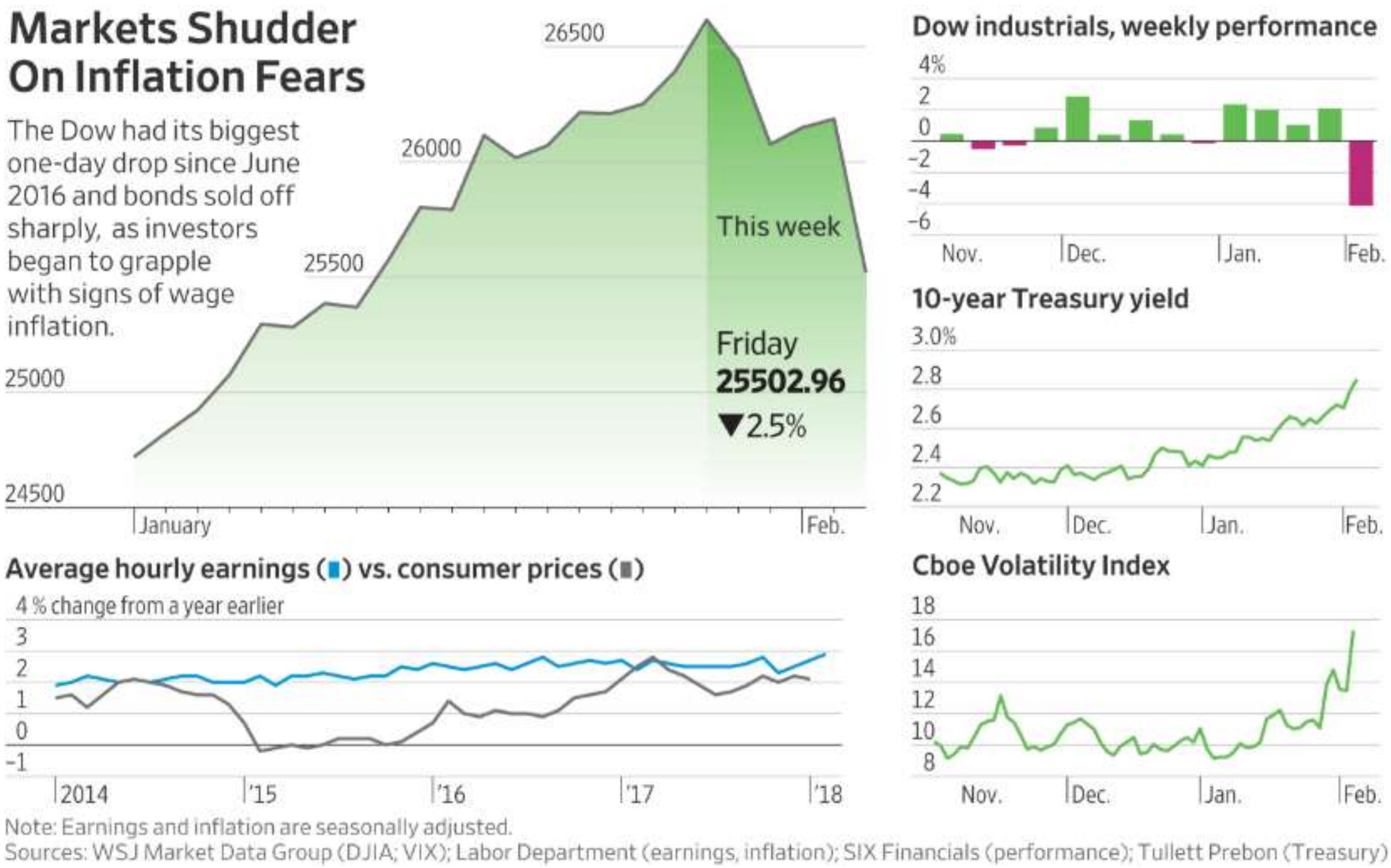
January 2018

"In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could." - Roger Dornbusch

The same often holds true for the stock market. This week's decline, the largest in over 2 years, brought to an abrupt end the S&P 500's historic (449 day) climb without even a 3% drawdown. From the front page of this weekend's WSJ:



Wage Growth Feeds Market Unease

Dow drops 4.1% in week, bonds slide as investors start taking threat of inflation more seriously

By Corrie Driebusch and Daniel Kruger Feb. 2, 2018

A rare burst of volatility jolted financial markets and sent stocks and bonds tumbling Friday, a sharp shift from the tranquility that has characterized much of the nearly nine-year bull-market run.

The Dow Jones Industrial Average dropped 2.5%, its biggest one-day decline since the U.K.'s surprise vote to leave the European Union in June 2016. Meanwhile, the yield on the benchmark 10-year Treasury note climbed to 2.852%, its highest level since January 2014.

Bond investors have started to take the threat of inflation more seriously, and an anticipated rise in interest rates spooked stock investors. ...

For most of the current bull market, easy money policies had pushed investors away from the paltry returns offered by government debt and into stocks. ...

Now, the fear is that the past week's selloff—the Dow posted a 4.1% decline, its biggest weekly drop since January 2016—could mark the start of a more tumultuous period in markets.

"People are questioning the conditioning that every dip will be bought," said Mohamed El-Erian, chief economic adviser at Allianz, referring to both the bond and stock markets. He added the global economy continues to be strong, but he expects this pickup in gyrations to continue.

... The Dow rose 5.8% in January as strong economic and corporate-earnings growth invigorated investors, who poured $100 billion into equity funds in January, their biggest monthly inflow on record, according to fund-tracker EPFR Global. ...

The Dow posted two moves of at least 1% in the past week, compared with 10 in all of 2017. The CBOE Volatility Index, which measures expected stock swings over the next month, on Friday notched its highest close since November 2016, when jitters around the U.S. presidential election escalated.

The recent volatility continued Friday following the January jobs report. Wage growth accelerated, rising 2.9% over the past year, the strongest year-over-year gain since June 2009, according to the Labor Department. Government-bond yields rose as investors interpreted the wage gains as a sign the tightening labor market may finally trigger higher inflation. ...

The Dow fell 665.75 points to 25520.96 Friday, its biggest one-day point drop since December 2008. For the week, the blue-chip index fell nearly 1100 points, the most since the throes of the financial crisis in October 2008. ...

The S&P 500 lost 59.85 points, or 2.1%, to 2762.13 and the Nasdaq Composite dropped 144.92, or 2%, to 7240.95. All three indexes remain higher in 2018, with the Dow and S&P 500 up more than 3% and the Nasdaq up 4.9%. ...

"I don't see much panic out there," (see SentimenTrader below) said David Kelly, chief global strategist at J.P. Morgan Asset Management. The real danger for stocks isn't Treasury yields climbing above 3%, but a recession, he said, adding that as long as central banks maintain their slow and steady pace of rate increases and corporate earnings remain solid, he doesn't foresee a recession in the near future. ...

From Friday's SentimenTrader: "... it's hard to argue with the fact that it was a shocking day, at least in terms of what investors have become accustomed to over the past year. I've noted before that a 2% decline would be a 4 standard deviation event, and ... Friday's drop indeed was that extreme. We don't see that often, especially when the S&P was just sitting at a new high within the past week. ... We can see that after the other times that's occurred, the S&P rebounded almost every time across almost every time frame. Most impressive was the risk/reward over the medium-term. Three months later, reward was more than 4 times the risk, and that improved even more over six months." From Wednesday's:

What Happens Next to the Stock Market After Tuesday's Horrid Bloodbath?

Wall Street is still stunned by Tuesday's vicious market rout. The big question everyone is asking: What's the next move?

By Brian Sozzi
Jan 31, 2018 9:11 AM EST

WATCHLIST

WHAT STOCKS ARE YOU WATCHING?

Sign up to get started or log in to see your watchlist.

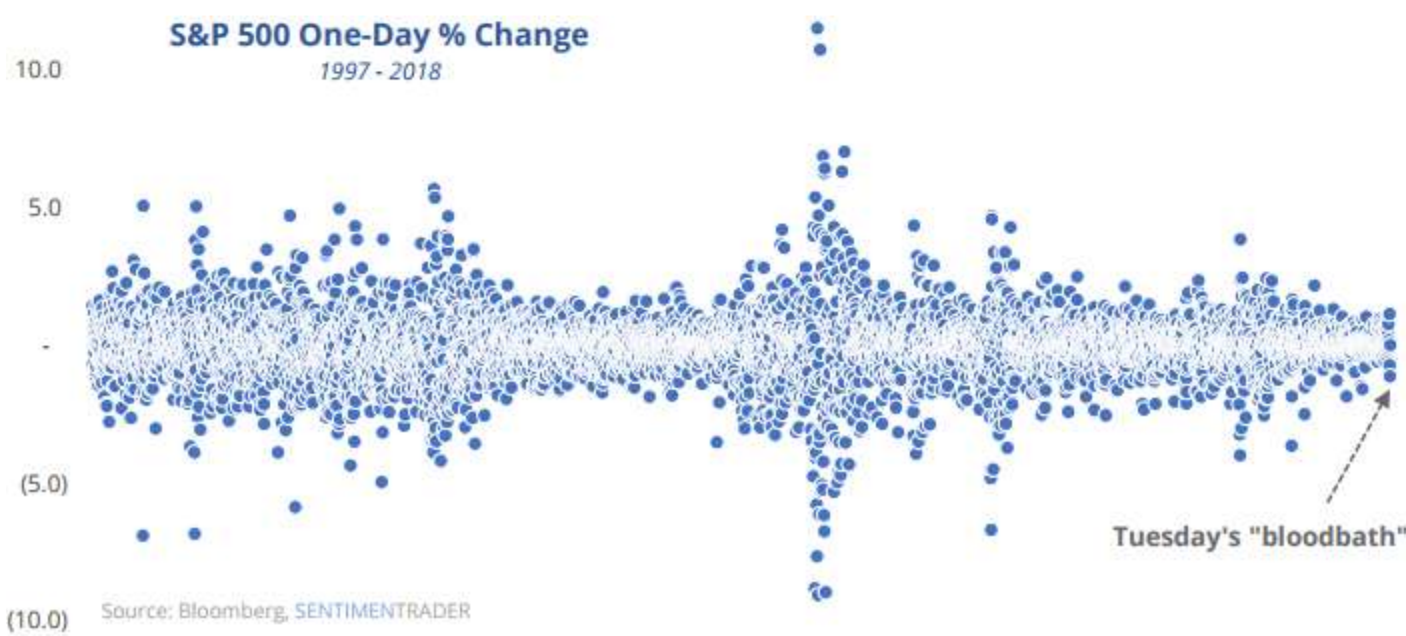
SIGN UP

LOG IN

ADVERTISING PARTNERS

According to these folks, “one should be cautious on the market after a rout like Tuesday’s.” For perspective, we can see Tuesday’s “vicious rout” on the chart below. ...

From Friday's



From Friday's Global Investment Strategy, titled "Take Out Some Insurance":

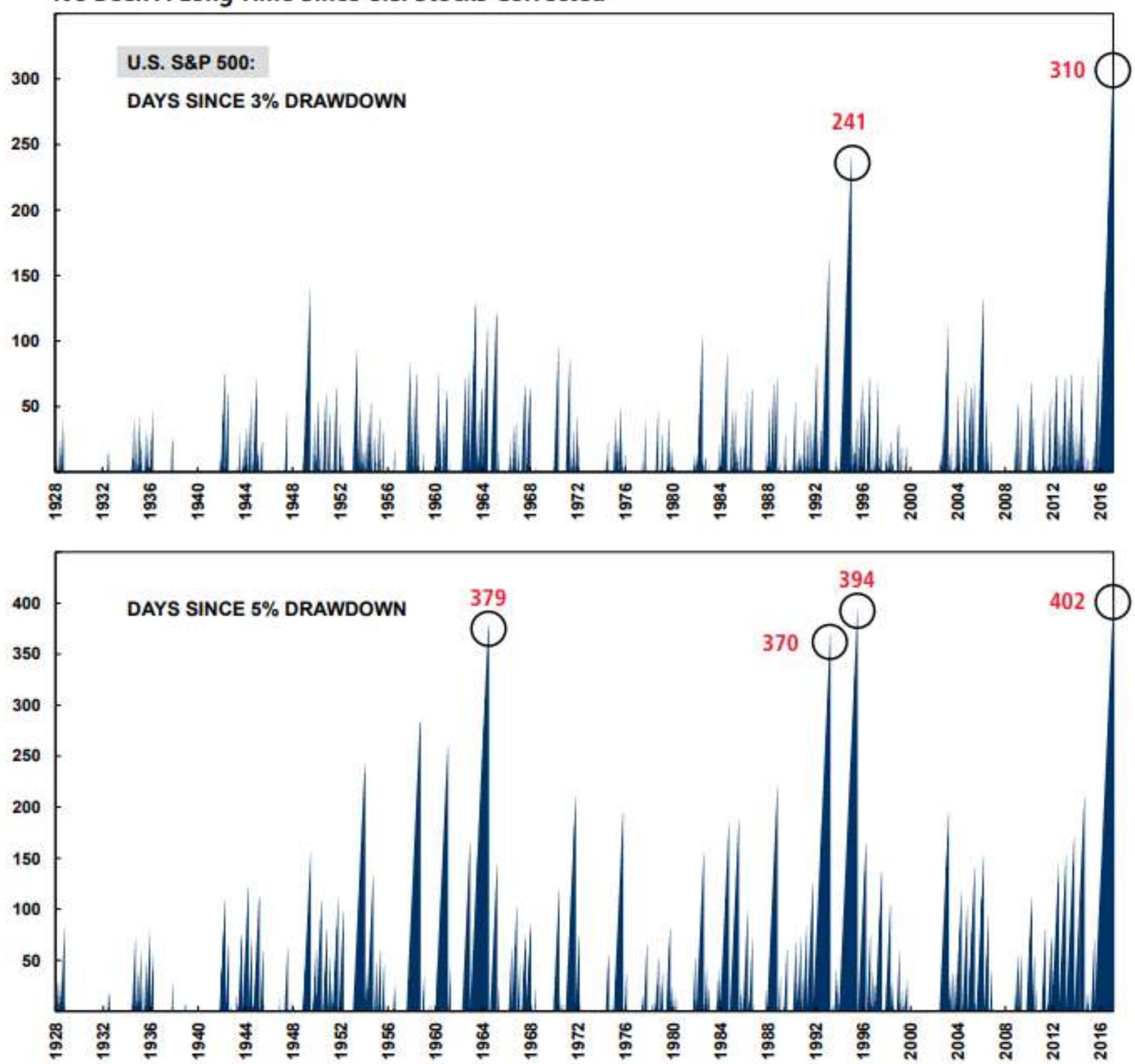
A Cloudy Picture

As a rule of thumb, technical factors drive stocks over short-term horizons of one-to-three months, business cycle developments and financial conditions drive stocks over horizons of one-to-two years, and valuations drive stocks over ultra long-term horizons of five years and beyond.

Occasionally, all three sets of signals line up in the same direction. In March 2009, the combination of bombed-out sentiment, cheap valuations, green shoots in the economy, and the expansion of the Fed's QE program all aligned to mark the beginning of a powerful bull market in stocks. Unfortunately, today the calculus is not so simple.

CHART 2

It's Been A Long Time Since U.S. Stocks Corrected



NOTE: 1-YEAR ROLLING PEAK IN S&P 500 USED TO CALCUATE DRAWDOWN. BASED ON DAILY CLOSE DATA.

Stocks Are Technically Overbought

Technically, the stock market has gotten ahead of itself. The S&P 500 Relative Strength Index hit a record high earlier this week, while our Technical Indicator reached a post-recession high. The S&P has now gone 310 days without a 3% drawdown and 402 days without a 5% drawdown – both records (Chart 2).

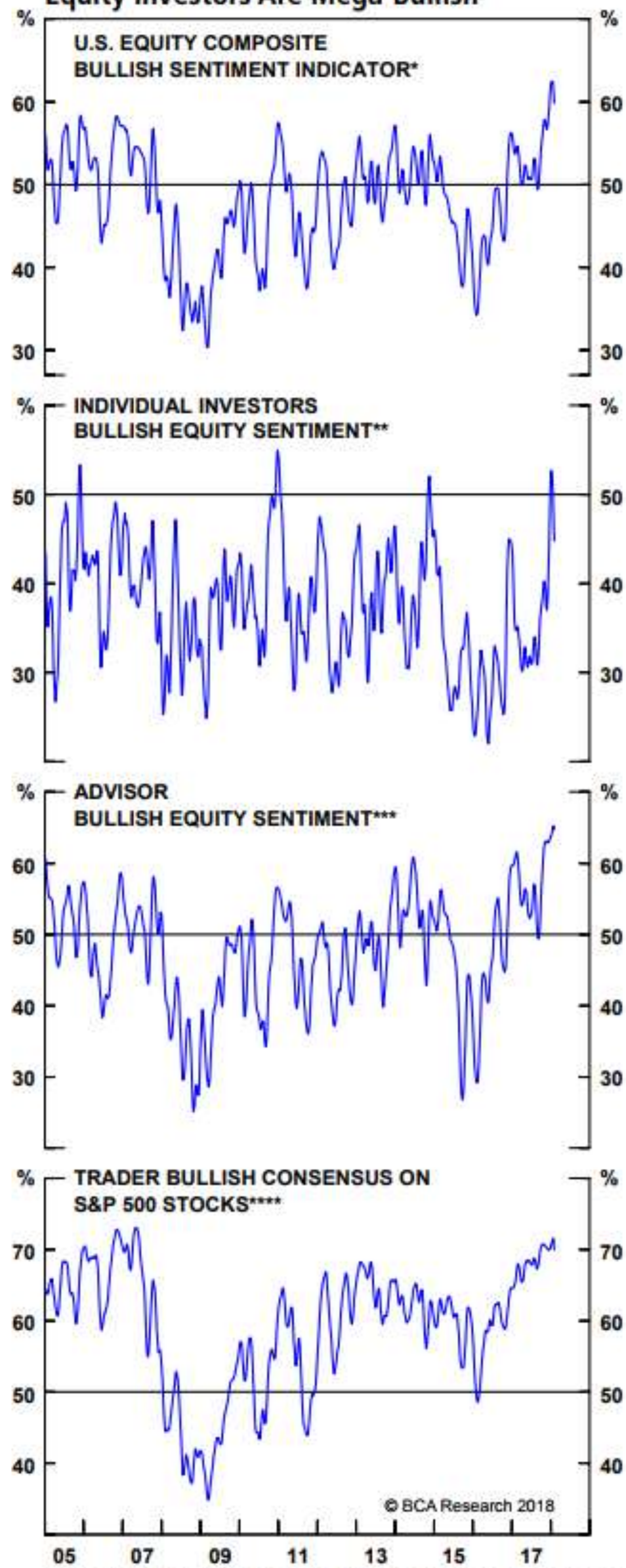
Irrational exuberance is back. Our Composite Sentiment Indicator has jumped to the highest level since right before the 1987 crash (Chart 3). Retail investors are also flooding back into the market. Discount brokers such as E*TRADE and Ameritrade have seen a flurry of activity (Chart 4).The latest monthly survey conducted by the American Association of Individual Investors showed that respondents had the largest allocation to stocks since 2000 (Chart 5).

The Economy And Earnings Still Paint A Bullish Backdrop

In contrast to the ominous technical picture, the cyclical outlook for stocks looks reasonably solid (Chart 6). The Citigroup Economic Surprise Index for major advanced economies has risen to near record-high levels. Goldman's

CHART 3

Equity Investors Are Mega-Bullish



* BASED ON INDIVIDUAL INVESTOR, ADVISOR, AND TRADER SENTIMENT.
** SOURCE: AMERICAN ASSOCIATION OF INDIVIDUAL INVESTORS.
*** SOURCE: INVESTORS INTELLIGENCE.
**** SOURCE: MARKETVANE.NET.
ALL SERIES SHOWN SMOOTHED EXCEPT FOR LATEST DATAPOINT.

CHART 4

Retail Investors Have Piled In (Part I)

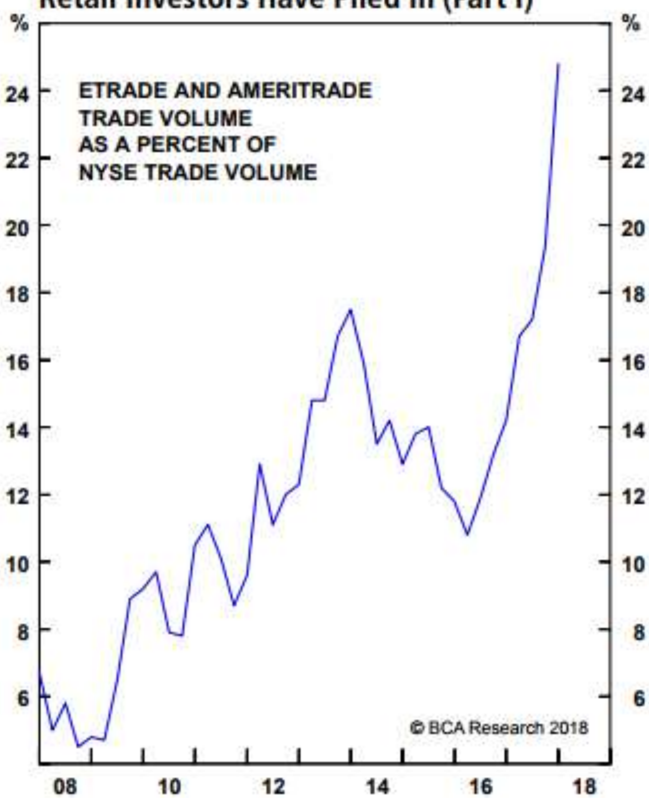
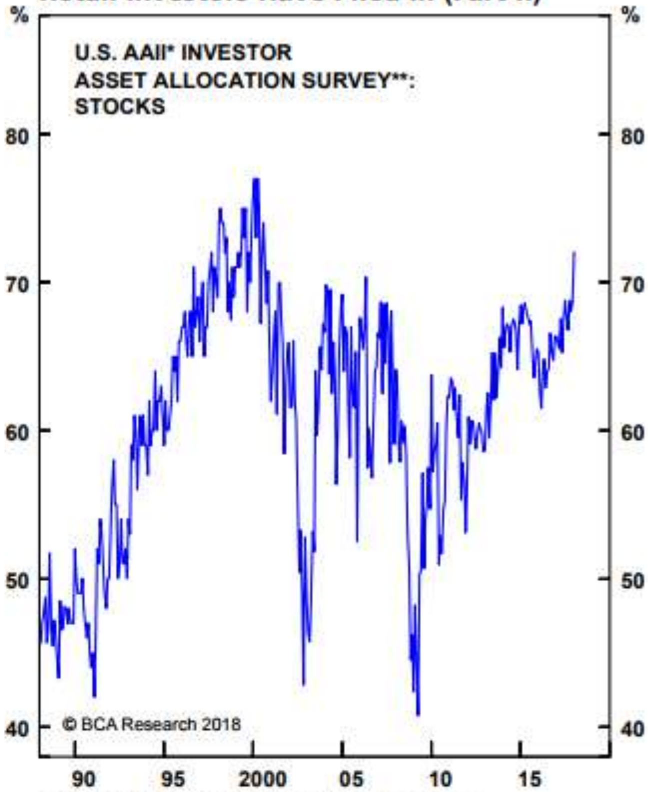


CHART 5

Retail Investors Have Piled In (Part II)



* AMERICAN ASSOCIATION OF INDIVIDUAL INVESTORS.
** CURRENT PERCENTAGE OF PORTFOLIO; SHOWN SMOOTHED EXCEPT FOR LATEST DATA POINT.

Global Current Activity Indicator stands close to a cycle high of 5%, up from 2.2% at the start of 2016. Our Global Leading Indicator has decelerated somewhat, but is still pointing to above-trend growth this year.

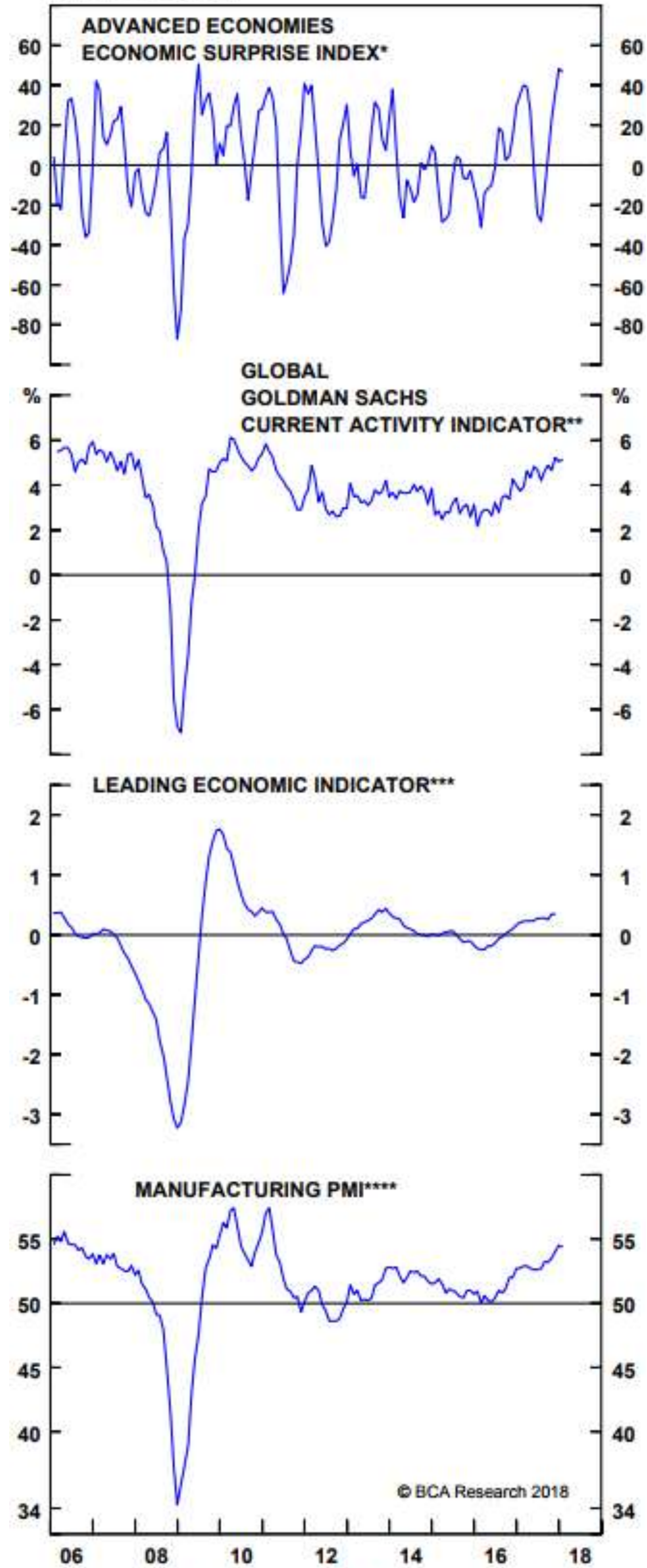
Growth in the euro area remains strong. The economy grew by 2.5% in 2017, the fastest pace since 2007. U.S. growth is gathering steam. Real private final demand increased by 4.6% in Q4. The Atlanta Fed's GDPNow model is signaling growth of 5.4% in the first quarter, while the New York Fed Staff Nowcast is pointing to a more plausible growth rate of 3.1%.

Reflecting the strong economy, corporate profits are ripping higher. 45% of S&P 500 companies have reported 2017 Q4 results. 80% have beaten consensus EPS projections, above the long-term average of 69%. 82% have beaten revenue projections, which also exceeds the long-term average of 56%.

The fact that earnings and revenue have surprised so strongly to the upside is all the more impressive given the sharp increase in EPS estimates over the past few months.

CHART 6

Economic Outlook Remains Solid



* GDP-WEIGHED AVERAGE OF U.S., U.K., EURO AREA, AND JAPAN. ROLLING 3-MONTH STANDARD DEVIATION OF DATA SURPRISES. SOURCE: CITIGROUP GLOBAL MARKETS INC.
** SOURCE: GOLDMAN SACHS (ACCESSED VIA BLOOMBERG FINANCE L.P.).
*** BASED ON BCA CALCULATIONS.
**** SOURCE: J.P. MORGAN / MARKIT.

Moreover, the improvement in earnings has been broad-based across sectors.

Financial Conditions Are Supportive, But Rising Bond Yields Are A Risk

Financial and monetary conditions remain accommodative, as judged by an assortment of financial conditions indices (Chart 8). ...

CHART 8

Financial Conditions Have Eased

* SOURCE: GOLDMAN SACHS (ACCESSED VIA BLOOMBERG FINANCE L.P.).

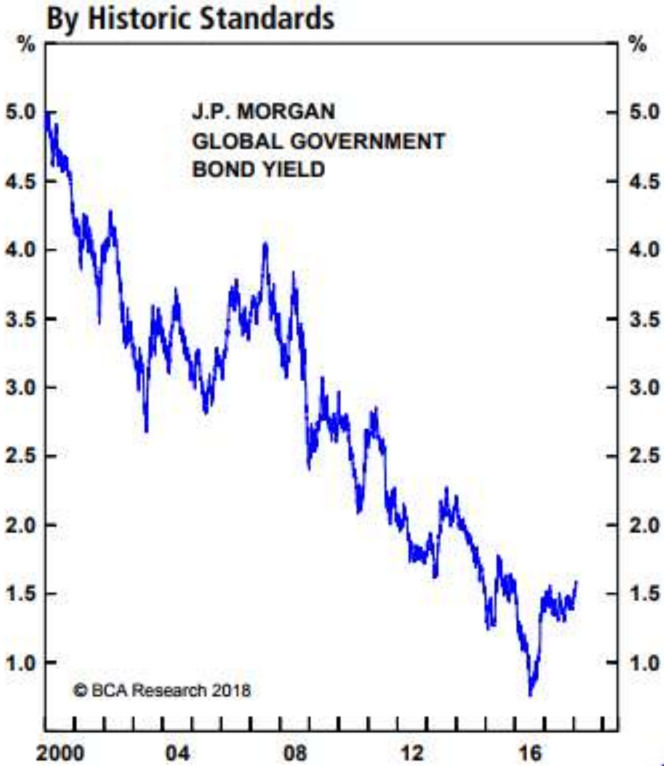
The recent rapid ascent in global bond yields complicates matters. So far, much of the increase in yields has been driven by higher inflation expectations. This has kept real yields down. Indeed, real 2-year yields have actually declined in the euro area and Japan over the last several months.

In absolute terms, yields are still low by historic standards (Chart 10). As my colleague Doug Peta, who heads our Global ETF Strategy service, has documented, rising bond yields pose a bigger problem for the economy and risk assets when they move into restrictive territory (Table 2). We are not there yet. Stronger global growth and diminished spare capacity have pushed up the pain threshold for when rising bond yields begin to bite. In the U.S., fiscal stimulus and a cheaper dollar have also caused the neutral rate to rise.

Nevertheless, equities often struggle to digest rapid

CHART 10

Yields Are Still Low By Historic Standards



increases in bond yields. Although the late 2016 episode stands out as an exception, stocks have typically floundered following an increase in global bond yields of around 50 bps. The yield on the JP Morgan Global Government Bond index has risen by 27 bps since last autumn. If yields continue their swift ascent, stocks could come under pressure.

Valuation Concerns

Valuations are not much use for timing the stock market, but they are the most important driver of returns over the long haul. ...

The picture is somewhat better outside the U.S. Our composite valuation measure – which combines trailing P/E, price-to-sales, price-to-book, Tobin's Q, and market capitalization-to-GDP – suggests that most stock markets outside the U.S. will see returns in the low-to-mid single-digit range over the next ten years. Nevertheless, this is still well below the historic average return for these markets.

TABLE 2

Aggregate Real S&P 500 Returns During Rate Cycle Phases From August 1961

	AGGREGATE	
	CAGR	# OF MONTHS
PHASE I (EASY, HIKING)	4.1%	211
PHASE II (TIGHT, HIKING)	-5.9%	101
PHASE III (TIGHT, CUTTING)	2.4%	109
PHASE IV (EASY, CUTTING)	6.0%	257
EASY (PHASES I AND IV)	5.1%	468
TIGHT (PHASES II AND III)	-1.7%	210
HIKING (PHASES I AND II)	0.7%	312
CUTTING (PHASES III AND IV)	4.9%	366
TOTAL PERIOD (ALL PHASES)	3.0%	678

Please see *U.S. Investment Strategy Special Report*, "Stocks and the Fed Funds Rate Cycle," dated December 23, 2013.

What To Do?

Our cyclical overweight in global equities has worked out well, and barring evidence that the global economy is tipping into recession, we intend to maintain this recommendation. Nevertheless, the discussion above suggests that stocks are vulnerable to a near-term correction and that long-term returns are likely to be lackluster at best. As such, it is sensible to take out some insurance against a market selloff.

The question, as always, is how to guard against a drop in equity prices without suffering too much of a drag if global bourses continue to grind higher.

We noted three weeks ago that today's equity bull market is starting to look increasingly like the one in the late 1990s. Back then, rising equity prices were accompanied by both higher volatility and wider credit spreads.

History seems to be repeating itself. The VIX bottomed on November 24 at 8.56 and ended last week at 11.08, even as the S&P 500 hit another record high. Investors should consider buying volatility futures on any major dip in the VIX. (A nice call if it had come a day earlier, and not included "on any major dip", as the VIX climbed 28.5% on Friday. As we have repeatedly stated, we don't attempt to time the market. It is our job to make sure a client's portfolio is aligned with their Risk Profile and contains those stocks and funds that provide the best opportunity to outperform over the long-term within that parameter.)

In my class Advanced Topics in Investments that I'm teaching at OU, the initial lectures covered financial bubbles from Tulips to Bitcoin. From Bloomberg yesterday:

Bitcoin Whipsaws Investors as Bubble Shows Signs of Bursting

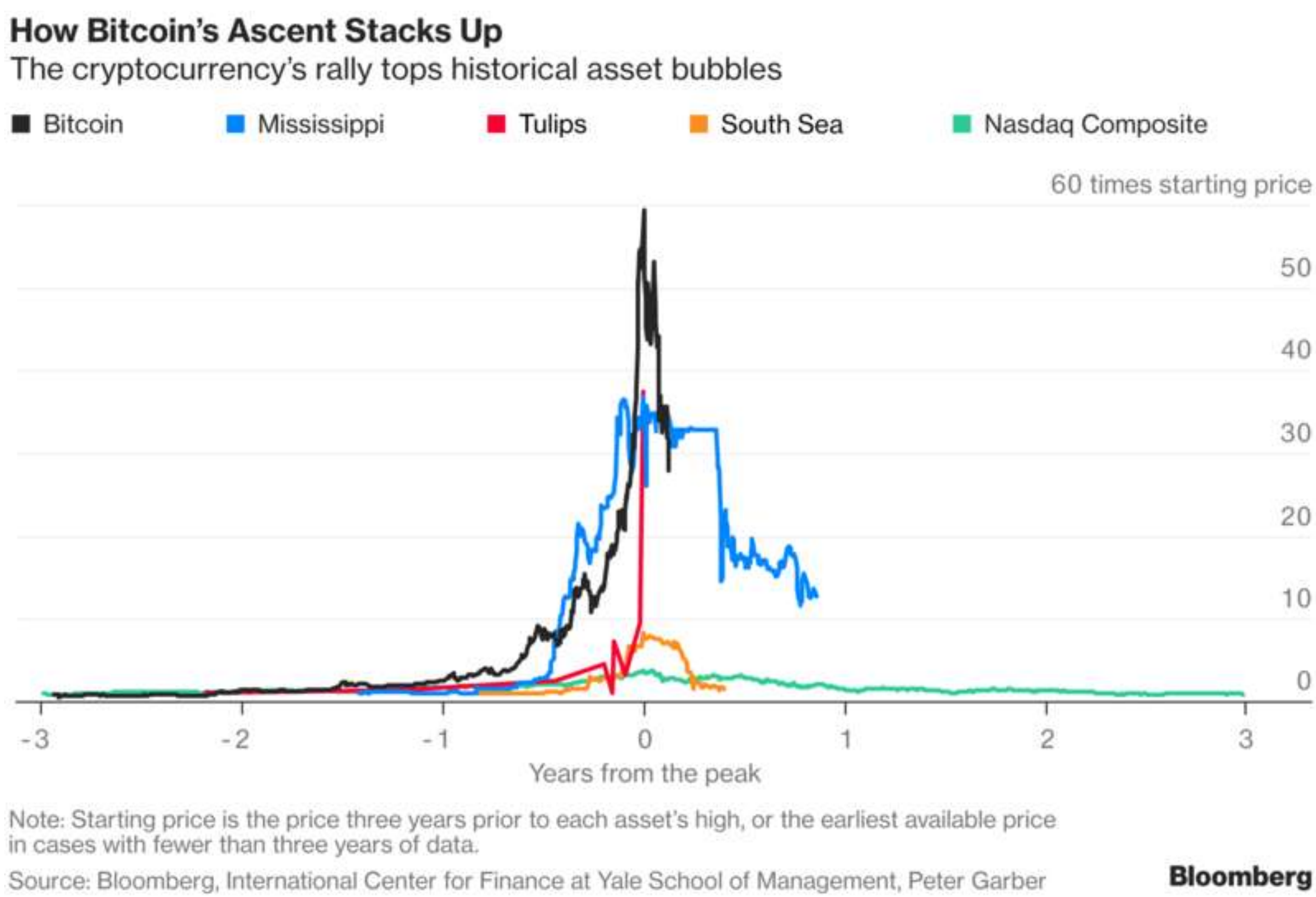
By Eric Lam, Dani Burger, and Joanna Ossinger

February 2, 2018

Bitcoin whipsawed investors, falling below $8,000 for the first time since November before recovering most of today's losses, as a miserable 2018 continued for cryptocurrencies, with investors confronting a mounting list of concerns about the future of the industry.

Since reaching a record high of $19,511 on Dec. 18 shortly after the introduction of regulated futures contracts in the U.S., Bitcoin has wiped out more than half its value amid waves of negative news. Setbacks included escalating regulatory threats from authorities around the world including India, South Korea, China and the U.S., a record $500 million heist at Japanese exchange Coincheck Inc., fears of price manipulation and Facebook's ban on cryptocurrency ads. ...

The largest digital currency dropped as much as 16 percent to $7,643, before trading at $8,715 at 9:52 a.m. in New York, according to consolidated Bloomberg pricing. Bitcoin is down 21 percent on the week. Rival coins Ripple, Ether and Litecoin tumbled at least 18 percent as losses continued to spread across cryptocurrencies.



Nouriel Roubini of Roubini Macro Associates said Bitcoin is the "mother of all bubbles," and its bubble is now bursting, speaking in an interview on Bloomberg Television. He said "virtually every" Group of 20 country is talking about cracking down on the phenomenon as policymaker worries grow.

Positions

FSIC - Added a second BDC to most clients investing in individual stocks @ 7.486 on 1/2/18.

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)	Close Price
12/29/2017	3	FORMAN MICHAEL CRAIG, ...		21,997	7.3500
12/28/2017	4	FORMAN MICHAEL CRAIG, ...		44,972	7.4000
12/13/2017	1	HAGAN MICHAEL J		30,000	7.8000

From BDC Buzz on 12/11/17:

Summary

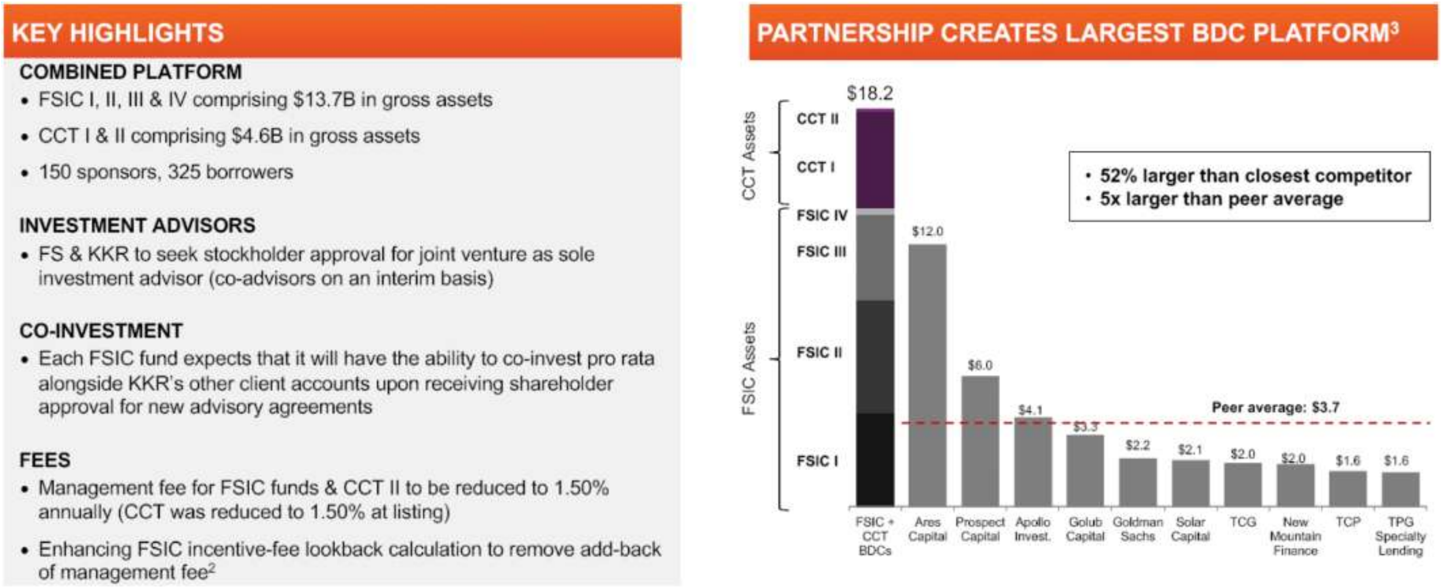
- This morning, Franklin Square & KKR announced the intention to merge their BDC platforms (private and public) to create the largest BDC with $18 billion in assets.

- There are many advantages to this transaction including portfolio diversification, scale, differentiated origination capabilities and expertise, enhanced deal flow and expanded proprietary investment opportunities.

- The Boards have approved the new advisory agreements for FSIC (including lowered hurdle from 7.5% to 7.0%) and CCT and are seeking shareholder approval in January 2018.

- KKR will provide non-advisory services to FSIC until approvals are in place and will conclude its relationship with GSO Capital Partners as a part of the transaction.

- There is a chance that I will be purchasing shares after the calls and depending on pricing.



on 12/20/17:

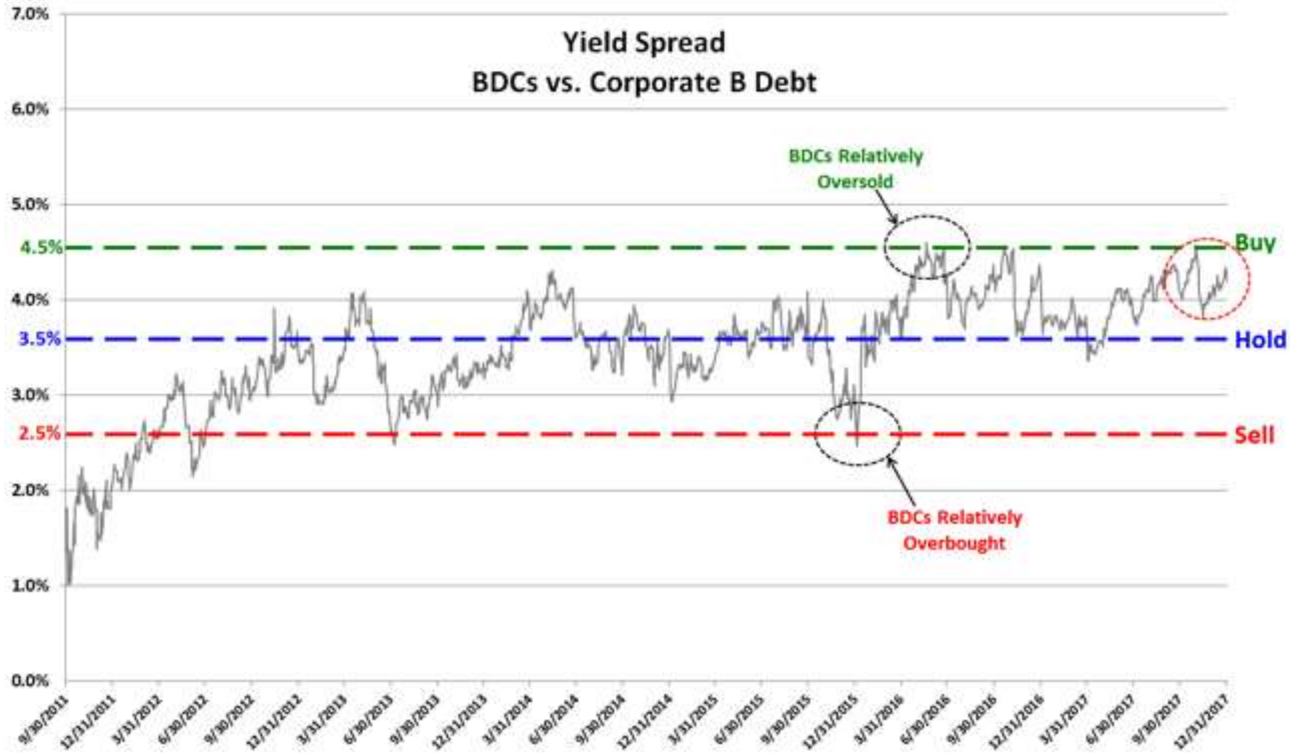
I purchased additional shares of FSIC at an average price of $7.80

on 1/3/18:

Overbought or Oversold?

I closely watch the yield spreads between BDCs and other investments including the '[BofA Merrill Lynch US Corporate B Index]' (Corp B). The current spread is around 4.2% (the difference between 10.0% for BDCs and 5.8% for Corp B). Yield spreads are important to monitor as they can indicate when a basket of investments is overbought or oversold compared to other yield-related investments. ...

The following chart uses the information from the previous chart showing the average yield spread between BDCs and Corp B. I consider BDCs oversold when yields approach 4.5% higher and overbought when yields are closer to 2.5% higher. This would imply that BDCs are currently oversold relative to Corp B debt yields.

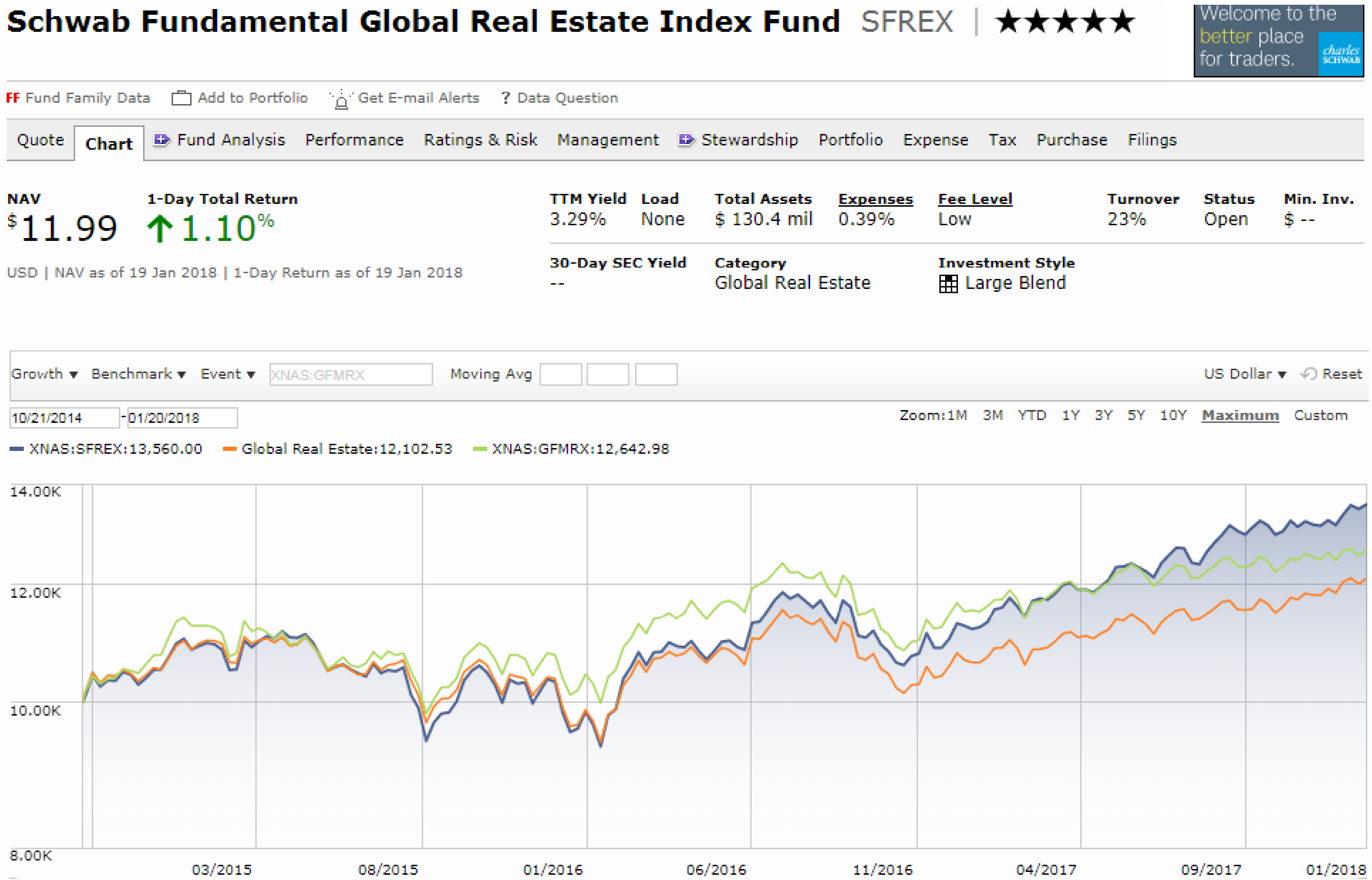


GPMT - On 1/10 this externally managed cmREIT was purchased @ 17.46 for 2 clients investing in individual stocks that didn't already hold ARI. It's IPO @ 19.5 was on 6/22/17, and it is currently yielding 9.0%. From the company's website: "Granite Point Mortgage Trust focuses primarily on directly originating, investing in and managing senior floating-rate commercial mortgage loans and other debt and debt-like commercial real estate investments." Due to their floating-rate loans, cmREITs tend to do well when interest rates are rising within a good economy.

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
TAYLOR BRIAN Director	Purchase at $17.87 per share.	Direct	100,072	Nov 15, 2017	5,600
SANDERS WILLIAM REID Director	Acquisition (Non Open Market) at $17.79 per share.	Indirect	177,900	Nov 13, 2017	10,000
SANDERS WILLIAM REID Director	Purchase at $17.49 per share.	Direct	262,350	Nov 12, 2017	15,000
PLUST STEVEN Officer	Purchase at $17.63 per share.	Direct	48,482	Nov 12, 2017	2,750
TAYLOR JOHN A Officer	Purchase at $17.74 per share.	Direct	102,891	Nov 09, 2017	5,800
ROTH WILLIAM Director	Purchase at $17.50 per share.	Direct	43,750	Nov 09, 2017	2,500
ALPART STEPHEN Officer	Purchase at $17.70 per share.	Direct	51,011	Nov 09, 2017	2,882
SANDERS WILLIAM REID Director	Purchase at $17.68 per share.	Direct	106,080	Nov 09, 2017	6,000
ROTH WILLIAM Director	Purchase at $17.58 per share.	Direct	131,850	Nov 08, 2017	7,500
URBASZEK MARCIN Officer	Purchase at $17.37 per share.	Direct	52,110	Nov 08, 2017	3,000
SANDERS WILLIAM REID Director	Purchase at $17.67 per share.	Direct	176,700	Nov 08, 2017	10,000

SFREX - We were able to get E*Trade to make this Schwab Global Real Estate OEF available. SFREX (blue line) is currently outperforming GFMRX (green line), which we were formerly using, with lower Expenses (0.39% vs. 1.0%) and **Risk** (0.9 vs. 1.1), as defined by Maximum Drawdown relative to S&P 500 declines of at least 10%. This passively managed "Fund leverages the Fundamental Index® methodology developed by Rob Arnott and his firm, Research Affiliates." On 1/16 we bought SFREX for a new client, and on 1/23 bought it to replace GFMRX in an IRA for an existing client. SFREX will replace GFMRX in taxable accounts next week.



SMLF - We bought this Domestic Multifactor ETF @ 40.82 as a Core holding in a Funds only Capital Appreciation portfolio for a new client on 1/16. From "For Factor Investors, It Pays to Go Small" by Morningstar's Alex Bryan, CFA on 12-6-17: "For those who do want to profit from momentum in the small-cap arena, it would probably be best to get that exposure through a multifactor fund, like iShares Edge MSCI Multifactor USA Small-Cap ETF (SMLF) (0.30% expense ratio). This is because 1) it will have lower turnover than a stand-alone momentum fund, and 2) it should better diversify risk. This fund targets small-cap stocks with strong value, momentum, quality, and small size characteristics under constraints that mitigate sector bets and turnover. Its holistic approach and demanding selection criteria should give it potent exposure to the factors it targets."

Morningstar's performance rating system requires that the fund be at least 3 years old:

"Morningstar rates mutual funds and ETFs from 1 to 5 stars based on how well they've performed (after adjusting for risk and accounting for sales charges) in comparison to similar funds and ETFs.

Within each Morningstar Category, the top 10% of funds and ETFs receive 5 stars and the bottom 10% receive 1 star. Funds and ETFs are rated for up to three time periods-three-, five-, and 10-years and these ratings are combined to produce an overall rating. Funds and ETFs with less than three years of history are not rated."

We have added the Russell 2000 (orange line), the most widely benchmarked index for domestic Small Caps, to Morningstar's chart for comparison:

iShares Edge MSCI Multifactor USA Small-Cap ETF SMLF

Morningstar StockInvestor
Free Download.

Last Price
$40.89

Day Change
↑0.53 | 1.31%

As of Wed 01/17/2018 3:36 PM EST |USD

Intraday Indicative Value
$40.84 ↑0.43 | 1.07%

As of Wed 01/17/2018 4:29 PM EST |USD

NAV	Open Price	Day Range	52-Week Range	12-Mo. Yield	Total Assets	Expenses
40.85 USD	40.60	40.57-40.94	34.50-41.05	0.93%	77.62 mil USD	0.30%

Prem/Discount	Volume	Avg Vol.	SEC Yield%	Bid/Ask/Spread	Category
0.11%	8333	9,739	—	38.29/ 43.28/ 12.23%	Small Blend

Benchmark ▼ Event ▼ XNAS:PLOAX Simple Moving Avg Reset

04/27/2015 - 01/16/2018 Zoom:1D 5D 1M 3M YTD 1Y 3Y 5Y 10Y Maximum Custom