

MRP CAPITAL INVESTMENTS, LLC

1st Quarter 2019 Client Newsletter

Capital Market Update

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In the 4th quarter of 2018, we said; *“I do truly believe when the dust settles a lot of these fears ruling the market today will turn out to be unfounded and never actually materialize. Per my analysis, it does look like there is significant upside to the markets when things settle down. But until then, we need to do the best we can with the cards we have been dealt.”*

In the 1st quarter, the S&P got off to the best start to a year since 1998. In fact, the price appreciation for the market was 13.07%. With this, it does appear that the fears that overwhelmed the market in the 4th quarter of 2018 got ahead of themselves and pushed the market down past a rational valuation level.



S&P 500 2019 Chart Supplied by BigCharts.com



The question moving forward will focus on how high can the market go while the rate of earnings growth is slowing? It is true that a lot of the “panic buttons” triggering the market’s sell off have been addressed. But the market is generally driven by earnings. Rest assured we will be keeping a VERY close eye on the upcoming earnings reports.

The Strangest Thing

As wild as the markets were during the 4th quarter of 2018 and the 1st quarter of 2019, I saw something even more mystifying during that time frame. In fact, it is this “mystifying thing” that may have been driving all of that crazy market behavior.



S&P 500 8/30/2018—03/30/2019 provided by BigCharts.com

If you will remember the markets were very weak in the 4th quarter and December was particularly bad. I wrote an article about that in the last newsletter entitled “Market Volatility.” In that article, I referenced Fed Chair Powell’s comments regarding how the Fed would unwind the very large balance sheet they built during the financial crisis of 2008. Almost verbatim, he said he wouldn’t stop the “autopilot” program that the unwinding of the balance sheet was on for any reason. He thought the automatic way it was letting the bonds mature was good for the markets because market participants could see exactly how many bonds were coming due and exactly when they were coming due. He liked the transparency of this process and he thought the markets appreciated it as well.

And it was exactly the time he began making these kinds of comments that the market began selling off. And the more he spoke, the more the market sold off.

But then with the release of the Fed minutes on February 20th, 2019, the Fed said they were going to end the “autopilot” program later this year. In fact, I found this 180 degree turn to be so significant that I put up a post on the website about it (www.mrpci.com/an-interesting-twist-from-the-fed). How could a Fed Chair be so vehement about not stopping the automated unwinding of the balance sheet one day and then, seemingly, the next day change his mind completely?!?!?

To be 100% frank, I am still not sure what made him change his mind so quickly. A lot of the newspapers and media outlets accused him of buckling to the pressures that Donald Trump was putting on him. I, personally, do not think that is the case. The Fed is an independent agency and Jerome Powell has a very prestigious background of leadership.



But what is concerning to me is the speed at which he changed gears. In the back of my mind, I am wondering/worrying that he has come across some information that has led him to believe the global economy is worse than he thought.



But this is at odds with how strong the market has been.



Which leads me to another worry. Could the global economy be slowing just as the masses have started to pour money into the market?

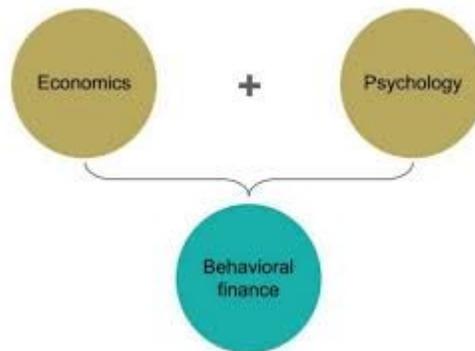


Time will always tell on things like this, but I am still keeping my eye firmly fixed on earnings. Earnings growth is supposed to slow to the 0-5% range for S&P 500 companies. This tells me it is time to take the risk profile of portfolios down a little. With this type of positioning should the market get weak, we should be a step ahead of the game.

A Turning Point?

Over the course of the last few years, we have written pretty extensively about certain investor behaviors that can drive the markets. It is this focus on what investors do and why they do it that is at the core of the science of Behavioral Finance. And it is this understanding of Behavioral Finance that helps us manage money with a little bit more confidence than many market participants.

In fact in mid-2018, we put out a research piece entitled “The Final Stages of A Bull.” In that, rather lengthy, report, we discussed some of the metrics we use to understand where the market is at and where it might be going. And many of those indicators are derived from our focus on Behavioral Finance.



In the conclusion section of the report, we wrote the following:

“Given that it would appear our current Boom Phase will be below average, I would expect this Bull Run to last at least another 2.5 years and for the S&P 500 to break 3,000. This is consistent with the historical studies of Boom Phases and puts the time from trough to peak below average AND the returns of the market below average.”

And then a few paragraphs later we added the following,

“Of course, near market tops irrational exuberance can take over or, as we’ve called it previously, the market can turn into a Reflexive Bull Market and irrational behaviors can feed off of each other and push the markets into La La Land. And we will be looking for signs of that, but in the meantime logical market participants can make a solid case for a continued run higher in the medium term and 3,000 certainly appears to be a barrier the market could breach.”

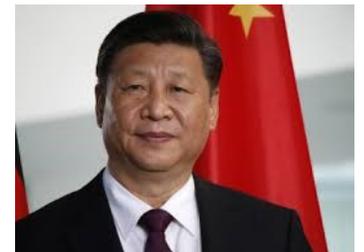
The reason I bring this up, is that I feel the market is pushing itself back up towards those “rational” valuation levels. But as we go higher and higher a lot of the worries in the market are being eliminated. The Mueller Report just came out and that investigation showed that the Trump campaign did not collude with the Russians during the 2016 Presidential Campaign. This helps eliminate the “impeachment worry.” And the market can get settled into a period of time without that cloud of uncertainty hanging over its head.



Another worry was how the United States would handle Kim Jung Un and his frequent missile launches. The worry was President Trump’s aggressive stance and rhetoric would agitate the North Korean dictator and World War III would break out. It appears that worry has been addressed and the Korean War is finally over and a long term peace treaty appears to be in the works.



And now the thing that keeps pushing the market up is optimism around the China-United States trade deal. Previously a lot of the market volatility was focused on the idea that a trade deal would never get done and a large scale Trade War would break out and decimate the global economy. At this point we don’t know for sure that a Trade Deal will get done, but there is a lot of optimism regarding the subject right now.



And the point is this, if we take all of the worries that are holding the market back and address each and every one of them, could we enter into that euphoria that we typically see at the end of Bull Markets? I think that answer is “yes” and I think we are getting pretty close to seeing if that will actually come to fruition.



And this is what I am calling the Tipping Point. Will we continue a rationally driven market and stick to the fundamentals or will emotions take over and will another Reflexive Bull Market break out? Of course, no one knows just yet. But history tells us that Bull Markets end with euphoria. If we remain rational, the upside to the market could be less dramatic but could last for quite awhile. If euphoria seeps into the market, we could see dramatic upside that departs from fundamentals.



Either way, we will continue to manage portfolios with each and every client’s objectives in mind and do our very best to continue to make educated and rational decisions in order to maximize the risk/return profile of the portfolios.

Non-Financial Events occurring this quarter



The crisis in Venezuela continued to worsen



The Mueller Report was published with no findings of collusion



NCAA Basketball March Madness got underway



Legendary investment professional John Bogle passed away

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