# *Notes from the Trading Desk*

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It was another strong week for U.S. equities as the recent rally continued unabated. Last week, the S&P 500 was up 2.89%, while the Nasdaq roared 3.78% higher. The Russell 2000 and the Dow were up 2.08%, and 1.57%, respectively. The S&P 500 is now just 4% away from its September highs. Perhaps more importantly, the S&P finally cleared the 2,816 level, where it had previously failed four times. So far this year, the S&P 500 has closed down on a weekly basis only twice. The rally has been strong, annualizing out to more than 77%.

Elsewhere, yields have been inching lower. The 10-year is sitting near 52-week lows at 2.59%. Even the 2-year yield has been trending lower over the last few months. Some of the action in yields could be attributed to the increasing probability that the Fed will cut rates by the end of the year. According to FactSet, the market currently is placing a 19.2% chance of a rate cut by the September Fed meeting. There is now a 0% chance of a further hike from the Fed. At the market's recent Christmas Eve bottom, the probability of a rate cut was 0% — even one month ago it was only 3.1% — but the odds of a rate hike, on Christmas Eve, were 25%. Many have been cheering the recent dovishness of the Fed — let the good time roll! We touched on this notion in our February 11th edition of *Notes*. At the time, we said,

> "The Fed's pause in hiking rates and the market's perception of even a rate cut this year are being lauded by the market as reasons to keep this party rocking! However, Fed pauses are typically not indicative of healthy markets. In fact, the Fed Funds Rate and the S&P 500 have shared a significantly positive correlation over the last 20 years. Greenspan paused in June of 2000, however, the market had already peaked. Bernanke paused in the summer of 2006 — though we all know what transpired a year later. On the flipside, Greenspan did successfully pause in 1995, which allowed the equity markets to roar for a few more years. Let's hope Powell's touch is more like early Greenspan, and not late Greenspan."

The cheeriness surrounding a potential rate cut is perplexing. We seem to be entering that odd twilight zone where good news is bad news and bad news is good news. The New York Fed is currently placing nearly a 30% chance of recession in the next twelve months. This is the highest probability since 2007, hence the potential rate cut. The NY Fed shows recession probabilities going back to 1959. Each time we have reached probabilities this high, we have entered a recession — with the exception of the mid 1960s, though we entered a recession by 1970. In short, we have reached these levels 9 times in the last 60 years, 8 times we have slipped into a recession.

According to FactSet, Q1 earnings are now expected to contract by 3.6% — the first decline in earnings since Q2 2016. Full year earnings are expected to grow 4.1%, down from the 9.4% that was being projected at the end of the third quarter. However, despite the pessimism surrounding the state of the economy coming from Fed data — though not the Fed's words — and the continued deceleration of earnings, the market still has an implied 9.1% return over the next twelve months (This is according to FactSet and using a bottom-up price target for the S&P 500).

While the S&P is knocking on the door of all-time highs, it is worth keeping an eye on some of the underlying trends. First, the Dow Jones Transportation Average has been struggling mightily. It has made successively lower highs since its September high. The index has long been considered a bell weather for the underlying economy and a potential leading indicator for the S&P. Secondly, while the spread between 10s and 2s has been somewhat stable over the last few months, the spread between the 10-year to the 3-month treasury continued to flatten. The .1457% spread is the narrowest since 2007. Simply put, the 10-year is yielding 2.59% and the 90-day treasury is yielding 2.44% — wild! Parts of the yield curve remain inverted, as the 1-year is currently yielding more than 2, 3, 5, and 7-year treasuries. Even the 30-day is yielding more than the 2, 3, and 5-year treasuries. Ending on a high note, the VIX cleared through its recent lows and appears to be headed lower — a bullish sign for equities. Furthermore, there is little in the form of resistance between the S&P 500's current level and getting back to its all-time highs.

*Upgrades/Downgrades & Dividends*

**CVS** — Initiated outperform at Bernstein with a price target of $76 (3/13).

**D** — Initiated neutral at Mizuho Securities USA with a target of $76 (3/11).

**MSFT** — Initiated buy at Mizuho Securities USA with a target of $135 (3/13).

## Portfolio News & Notes

The portfolio was fairly quiet last week — the lone exception being Dollar General. DG came in a little light versus analyst estimates, reporting EPS of $1.84, while analyst's were estimating $1.89. However, the damage was really done with their forward guidance, which also came in light relative to estimates. By and large, they reported good numbers. Their comps were better than expected, and they announced a 10% increase in their dividend. The stock was punished for its guidance on Thursday as it fell nearly 10% in the morning. It ultimately rallied from there though, as it closed the week up 4.7% from its Thursday low.

| | WTD | MTD | QTD | YTD |
|---|---|---|---|---|
| Dow Jones | 1.57% | -0.26% | 10.81% | 10.81% |
| S&P 500 | 2.89% | 1.36% | 12.59% | 12.59% |
| Nasdaq | 3.78% | 2.07% | 15.87% | 15.87% |
| Russell 2000 | 2.08% | -1.40% | 15.20% | 15.20% |
| | | | | |
| Comm. Svcs | 2.30% | 2.96% | 14.25% | 14.25% |
| Con Disc | 2.56% | 0.88% | 11.92% | 11.92% |
| Con Staples | 2.24% | 1.36% | 8.68% | 8.68% |
| Energy | 3.21% | 1.02% | 14.33% | 14.33% |
| Financials | 2.98% | 0.75% | 11.78% | 11.78% |
| Health Care | 3.22% | 0.63% | 6.42% | 6.42% |
| Industrials | 0.29% | -2.50% | 15.15% | 15.15% |
| Info Tech | 4.87% | 3.34% | 17.76% | 17.76% |
| Materials | 1.68% | 0.96% | 9.71% | 9.71% |
| Utilities | 1.84% | 2.74% | 9.98% | 9.98% |
| REITs | 2.20% | 2.53% | 14.19% | 14.19% |

### Earnings Calendar

| Date | Time | Ticker |
|---|---|---|
| 3/21 | Post-Market | NKE |
| 3/26 | Pre-Market | FDS |
| 3/28 | Pre-Market | ACN |