DELTA
INVESTMENT
MANAGEMENT

Delta Insights
a weekly commentary on investing

January 4, 2019

A Repeat of 2011?

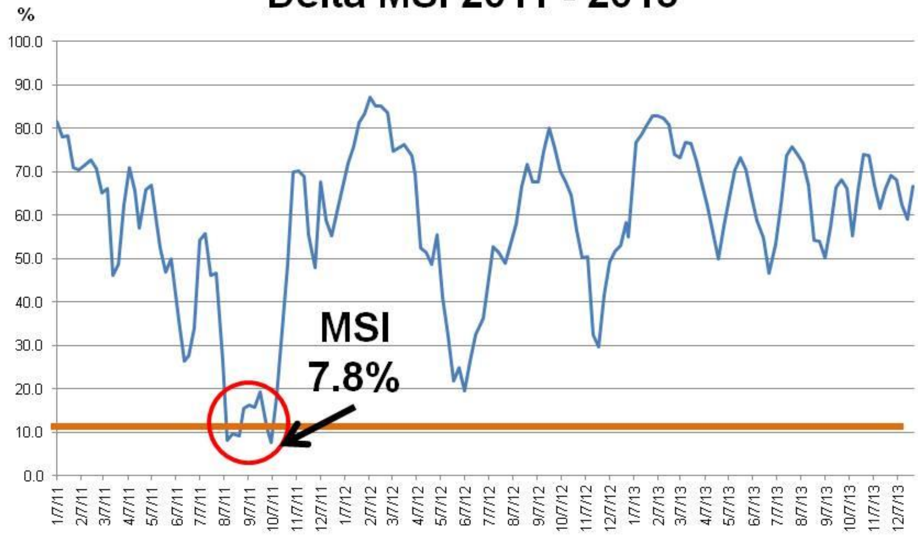
In 2011 S&P 500 earnings increased by about 15% and the market was roughly flat on the year. The 10-year treasury interest rate collapsed from about the mid 3% range to about 2%. Intra-year, stocks fell on over-hyped events abroad including the possibility that Greece would exit the Eurozone and negatively impact the euro currency. The Federal Government was shutdown with high levels of political divisiveness and squabbling. There was downbeat economic news including the downgrade of the U.S. debt rating.

With regard to the Federal Reserve, the common wisdom of the time was that they were no longer able to effectively support growth as “quantitative easing” measures were not meaningfully increasing the real money supply or otherwise stimulating borrowing demand.

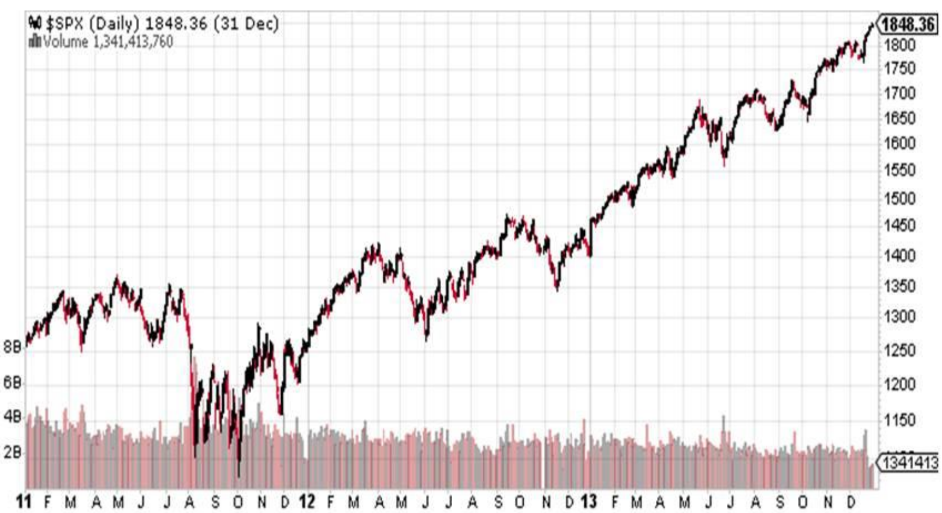
In a nutshell, Fed policy was failing, international economies were potentially unraveling and there was projected slow growth in the U.S. Today, many investors believe Fed rate policy is misguided, international markets are being disrupted by trade wars and growth is slowing. Like 2011, S&P 500 earnings advanced by double digits in 2018 while the stock market did not advance. The 10-year treasury rate fell from over 3.2% to 2.6% in the past two months as anxious investors sought the safety of government bonds.

In 2011, after a -21.6% decline in the S&P 500 intra-year, the Delta MSI reached 7.8% on October 5. The S&P 500 touched its low on October 4, 2011. Over the next two years, the S&P 500 climbed roughly 54%.

Delta MSI 2011 - 2013



S&P 500 Index 2011-2013



In 2018, after a -20.25% decline in the S&P 500 intra-year, the Delta MSI reached 7.5% on December 27. For now, the 52-week S&P low occurred on December 27, 2018.

In 2011, the S&P 500 P/E multiple on 2012 earnings (roughly 12 month forward earnings) reached a low of 11.3x. In 2018 at the low, the forward P/E multiple on estimated 2019 earnings was 13.4x. The 25-year average forward P/E is 16.1. Today, stocks are inexpensive relative to historical averages on a price-to-book, price-to-cash flow, dividend yield (2.3%) and earnings yield basis. Historically, when the Delta MSI declines below 10%, the market enjoys double digit returns over the next twelve months.

Key Statistics	2011	2018
High to Low %	-21.60%	-20.25
Time to Low	5 months	3 months
Low MSI Reading Date	Oct. 5, 2011	Dec. 27, 2018
Low MSI Reading Level	7.8%	7.5%
Market Low Date	Oct. 4, 2011	Dec. 27, 2018
S&P Fwd. earnings	$94.96 act.	$174.61 est.
S&P Fwd. P/E at Low	11.3x	13.4x
S&P 500 Return 2012	16.0%	2019?
S&P 500 Return 2013	32.4%	2020?
Cummulative 2-year return	53.6%	?

The biggest risk to the stock market and economy in 2019 appears to be continued trade tensions and uncertainty. China's most recent manufacturing index (PMI) fell below 50% to 49.7% indicating contraction in December. Korea and Taiwan have also declined below the 50% level.

Other than the negative effects of continued trade uncertainty, there are almost no tangible signs of an impending recession. What has changed is stock valuations are now inexpensive, 10-year treasury rates are about 50 basis points down from their highs which could re-stimulate the housing and auto sectors of the economy, oil prices have fallen from about $70/barrel to about $45/barrel which reduces gasoline prices and increases consumer discretionary income.

The headline PCE deflator (the Federal Reserve's primary measure of inflation) is at about 1.8%, below the 2% Fed target. With the recent decline in oil prices, JP Morgan Asset Management is estimating this inflation measure will decline to as low as 1.4% this year. With the recent stock decline (no asset bubble) and inflation well below the Fed target rate, JP Morgan expects the Fed to, at most, raise the Fed Funds rate one more time in June.

It is rather uncommon to have a year of strong earnings growth and stock market depreciation. Looking back at this combination in the past can offer a guide as to what is possible in the future.

Next week on Wednesday is our fourth quarter conference call with the *Delta Chart Book*. For current subscribers, we look forward to sending to you the Chart Book and call-in details next Tuesday. For those of you who are not currently subscribed, the annual subscription cost is $30. Give us a call or email if you wish to join the conversation.

Give Us a Call Today

We invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com if you have questions about how we can assist you in managing your investment accounts.

"Never, ever, think outside the box."

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

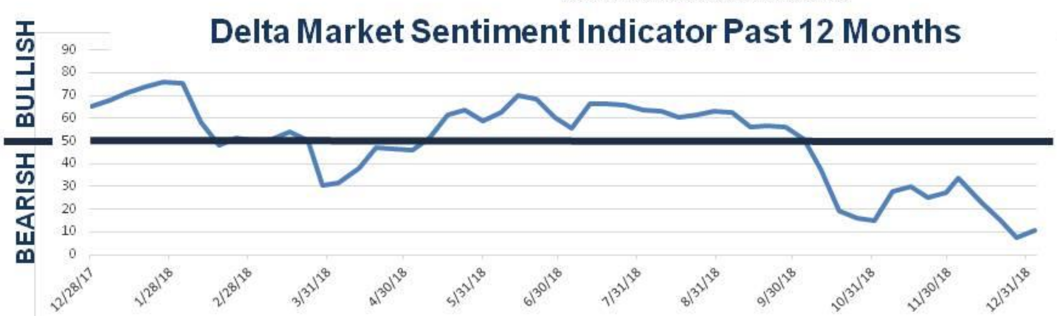
10.5

Our technical indicator increased this week from 7.5 to 10.5

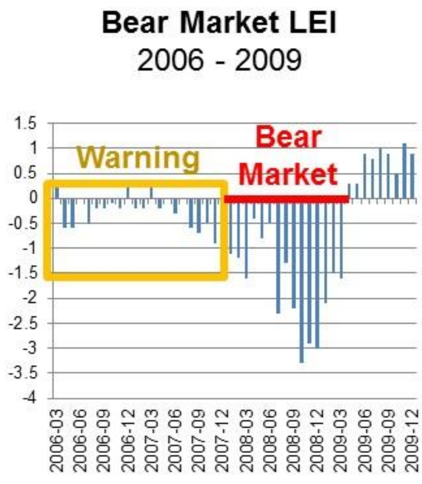
INDICATOR STATISTICS

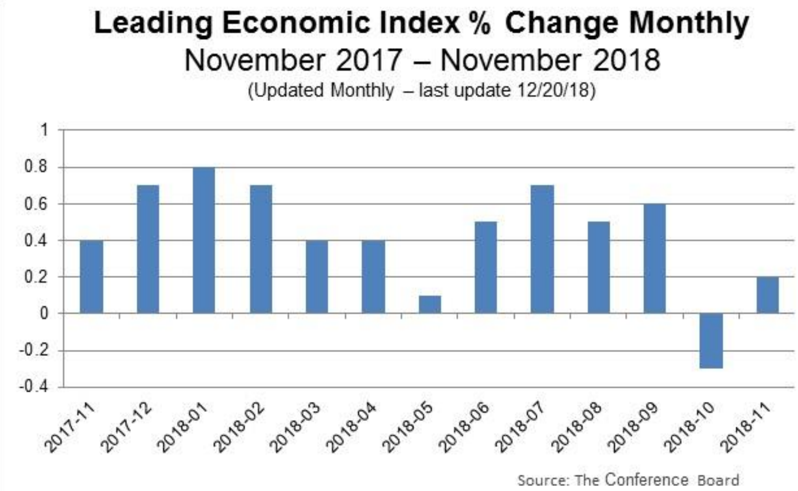
Consecutive Bearish Weeks:	13
Cycle Inception Date:	10/11/2018
Range:	7.5 - 37.4
Mean:	22.1
Bullish Weeks YTD:	0
Bearish Weeks YTD:	1
*S&P 500	-11.7%
*DJIA	-11.0%
*NASDAQ	-12.4%

** Percentage change during current cycle*



(Delta MSI is published every week in ***Barron's***)


Bear Market LEI
2006 - 2009
Warning
Bear
Market
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
-3.5
-4
2006-03
2006-06
2006-09
2006-12
2007-03
2007-06
2007-09
2007-12
2008-03
2008-06
2008-09
2008-12
2009-03
2009-06
2009-09
2009-12


Leading Economic Index % Change Monthly
November 2017 – November 2018
(Updated Monthly – last update 12/20/18)
1
0.8
0.6
0.4
0.2
0
-0.2
-0.4
2017-11
2017-12
2018-01
2018-02
2018-03
2018-04
2018-05
2018-06
2018-07
2018-08
2018-09
2018-10
2018-11
Source: The Conference Board