INVESTMENT COMMENTARY & OUTLOOK

October 9, 2019

Our dividend growth and conservative growth stocks are "locked and loaded" for the upcoming third-quarter announcement season. We are exiting the seasonally weak months for small-to-mid capitalization stocks and are now on the verge of when small-to-mid capitalization stocks tend to surge from an early "January effect" and remain strong well into the New Year.

The S&P 500 remains hindered by a strong U.S. dollar and is expected to post another lackluster round of third-quarter earnings results, which represent the trough in earnings, since more favorable year-over-year comparisons will help to boost the S&P 500's earnings in the upcoming quarters. The S&P 500 is hindered by the fact that approximately half of its sales are outside of the U.S., so multinational companies are being paid in depreciating currencies. In 2018 we saw a surge, a sugar rush of sorts, then a pause, that we are seeing right now. Furthermore, if there is a trade deal with China, we may see a re-acceleration in 2020. This was the pattern when President Reagan did his tax cuts in the 1980s and it was certainly the pattern when President Bush did his tax cut in 2003. So do not be surprised if 2020 turns out to be a great year for the economy, but we feel we do need a trade deal with China, so the present uncertainly does not weigh on sentiment.

Still, there is now a global recession unfolding so staying domestically oriented as much as possible is important. It now appears that Europe is slipping into a recession because the eurozone purchasing managers index (PMI) slipped to an 83-month low of 45.6 in September, down from 47 in August. Even worse, mighty Germany's manufacturing PMI slipped to 41.4 in September, down from 43.5 in August and is now at the lowest level in more than a decade. Since any reading under 50 signals a contraction, there is no doubt that Germany's GDP, which contracted in the second quarter, is likely to also contract in the third quarter.

The primary reason that the U.S. is not in a recession despite our own manufacturing woes is that the U.S. consumer remains healthy. As an example, the Commerce Department recently announced that new home sales soared 7.1% in August to an annual pace of 713,000. New home sales were especially strong in the South and West, which rose 6% and 16.5%, respectively. Overall, lower mortgage rates are now stimulating new home sales that are up 18% in the past 12 months!

The other factor helping U.S. economic growth is that the U.S. is now the largest energy producer and exporter in the world. Specifically, before the drone attack on Saudi Arabia's Aramco facilities that disrupted 5% of the world's crude oil production, the U.S. was the world's largest crude oil exporter in June. Ironically, due to Saudi Arabia's curtailed crude oil production, the U.S. is now decisively the largest exporter of crude oil in the world, so the U.S. trade deficit is expected to continue to shrink and help boost U.S. GDP growth.

Despite positive economic news, the political news in the U.S. is drowning out the other news, since the House of Representatives decided to proceed with a formal impeachment inquiry. The Trump Administration is being very aggressive in declassifying material for the House impeachment investigation so the jury is still out if the President gets impeached. Naturally, in most drawn out government fights, all parties can lose, but at least the

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facts are getting out there much faster than during the Muller investigation, so hopefully this national nightmare will not last too long.

While we are discussing politics, the country that makes the U.S. appear almost functional by comparison is Britain, which remains in chaos heading into Brexit on October 31st. Prime Minister Boris Johnson's tactic to utilize the Queen to suspend Parliament before Brexit backfired spectacularly, since the country's Supreme Court ruled that the suspension of Parliament was "unlawful." After meeting with President Trump recently, Boris Johnson had to hastily return to Britain where he said he "profoundly disagreed" with the Supreme Court ruling, but would "respect" it. Boris Johnson did talk to Queen Elizabeth and apologized for embarrassing her. Brexit is still on track for October 31st, if Boris Johnson can negotiate an exit agreement with the European Union. So keep your fingers crossed, since Parliament loves to humiliate and mock Boris Johnson in an obvious attempt to perpetually postpone Brexit.

Regarding the European economic chaos, we remain very worried about the European Central Bank's (ECB) negative interest rate policy. Outgoing ECB President Mario Draghi implemented Modern Monetary Theory (MMT) amidst much controversy. Essentially, MMT believes that increasing quantitative easing (i.e., essentially printing money to buy bonds, but for financial institutions only) is appropriate, as long as inflation does not materialize. However, after the ECB cut its key interest rate to -0.5%, down from -0.4%, and also boosted its bond buying program (i.e., quantitative easing) to support its negative interest rate policy, the euro immediately plunged to a two-year low relative to the U.S. dollar. A weaker euro will fuel potential inflation on imported goods, especially commodities, so MMT's additional quantitative easing creates a major inflation risk for the entire eurozone.

Complicating matters even further is incoming ECB President Christine Lagarde whose aid to Argentina while head of the International Monetary Fund, just turned out to be a "Band-Aid" due to the recent collapse of the Argentine peso as a result of the surprise outcome of the Argentine primary presidential election. We remain very worried about the ECB's negative interest rate policy under Christine Lagarde's leadership and expect that the euro will be at parity with the U.S. dollar no later than 2020.

After the September Federal Open Market Committee (FOMC) meeting, regarding slowing global growth and trade tension escalations, Fed Chairman Powell said that "There is a piece of this that we really can't address," and added, "It's an unusual situation ... It's a challenging time, I admit it." This last comment did not inspire confidence and prompted President Trump to tweet: "No 'guts,' no sense, no vision! A terrible communicator!" Yikes! We cringe every time President Trump now tweets about Chairman Powell and the Fed. Naturally, we realize the President is trying to force the Fed to catch up with market rates; but we worry that he will cause more dissension with the FOMC that already has too much dissension, as President Trump undermines Chairman Powell's leadership.

In the meantime, the Fed is now seriously considering cutting key interest rates at its next FOMC meeting in late October after weaker than expected manufacturing and service sector reports from the Institute of Supply Management (ISM). Furthermore, average hourly wages actually declined slightly in the September payroll report. Since the Fed wants to promote steady wage growth, an October key interest rate cut is now much more certain.

We should add that the Fed temporarily lost control of short-term interest rates recently that spiked briefly to 10%. This forced the Fed to step in and conduct repurchase (repo) operations for the first time in more than a decade to get interest rates back within its target range. The New York Fed initially conducted $75 billion of repurchases of Treasury, government agency, and mortgage-backed securities for two consecutive days and these repo operations were oversubscribed. As a result, the Fed decided to extend these repo operations through

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October 10th by selling at least $30 billion per day. So essentially the Fed is now adding to its balance sheet and re-inflating its reserves, although these "repo" operations are not formally called "quantitative" easing because they are designed to influence the short end of the yield curve. Additionally, this central bank action is what typically precedes quantitative easing that is designed to influence longer term Treasury notes, bonds, and government backed securities.

As investors look around the world, the U.S. remains an oasis, even amidst ongoing political chaos. Robust consumer spending and record energy production continue to allow the U.S. GDP to grow in excess of 2% without significant inflation and a shortage of qualified workers. The S&P 500's forecasted sales for the third quarter are currently running at a 2.8% annual pace, but earnings are expected to be lower due to contracting operating margins.

Fortunately, our growth stocks are characterized by much stronger forecasted sales and earnings growth as you can see in the following link:

https://navellier.com/private-clients/portfolios/sales-and-earnings-projections/?t=1

Our average growth stock continues to post impressive earnings surprises, so we remain very excited that we are entering the third-quarter announcement season "locked and loaded." As always, our best defense is a strong offense of companies that are characterized by strong sales and earnings growth as you can see in this link:

https://navellier.com/private-clients/portfolios/earnings-scoreboard/

SUMMARY

As always, we are entering the third-quarter announcement season "locked and loaded" and expect wave after wave of better than expected sales and earnings to propel our dividend growth and conservative growth portfolios higher. We are also now on the verge of when small-to-mid capitalization stocks tend to surge from an early "January effect" and remain strong well into the New Year.

Believe it or not, October marks the time of year when seasonal strength has historically materialized, even though October 1987 and 2018 were not positive months. According to our friends at Bespoke, in the past 100, 50, and 20 years, the Dow Industrials during October have risen an average of 0.34%, 0.70%, and 1.76%, respectively. Furthermore, in the past 100, 50, and 20 years, the Dow Industrials during November and December, on average, have risen significantly more than October. In other words, the seasonally strong time of year has finally arrived.

China's trade negotiators are descending on Washington D.C. in October and many observers have their fingers crossed that some progress to resolve the trade tiff may finally happen. We should add that China's is suffering from soaring pork prices and needs to buy more U.S. soybeans to curtail food inflation. Ironically, the tariffs have not hit U.S. consumers yet, due to a weak Chinese yuan and a strong U.S. dollar, import costs from China continue to decline. The financial media's attempt to scare investors about the Chinese trade tiff has been very irresponsible and is really just endless fear mongering. Since the U.S. has tremendous economic leverage over China, we would not be surprised if President's Trump and Xi agree on a face-saving trade deal.

In summary, we can be hysterical about a seemingly endless political circus or we can instead control our own destiny with our fundamentally superior dividend growth and conservative growth stocks. All too often, Wall Street "reacts" and does not "think," because it is essentially a manic crowd. Interestingly, many professional traders we know seem more distracted by the current football season than the latest political events, since we have become increasingly immune to the "outrage" that politicians like to manufacture and the media is all too eager to propagate. In the next few months, family, friends, and football during the holidays tend to overpower

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any and all political distractions. The next three months are expected to be prosperous, namely because people (including investors) tend to be happy during the holidays.

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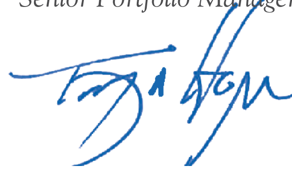

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