January 2019
Volume 11, Issue 2

Sandpiper Capital

Gleanings

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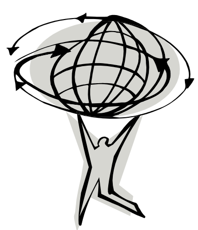
"The truth about recessions is that people don't lose their jobs because the economy contracts. The economy contracts when people lose their jobs"

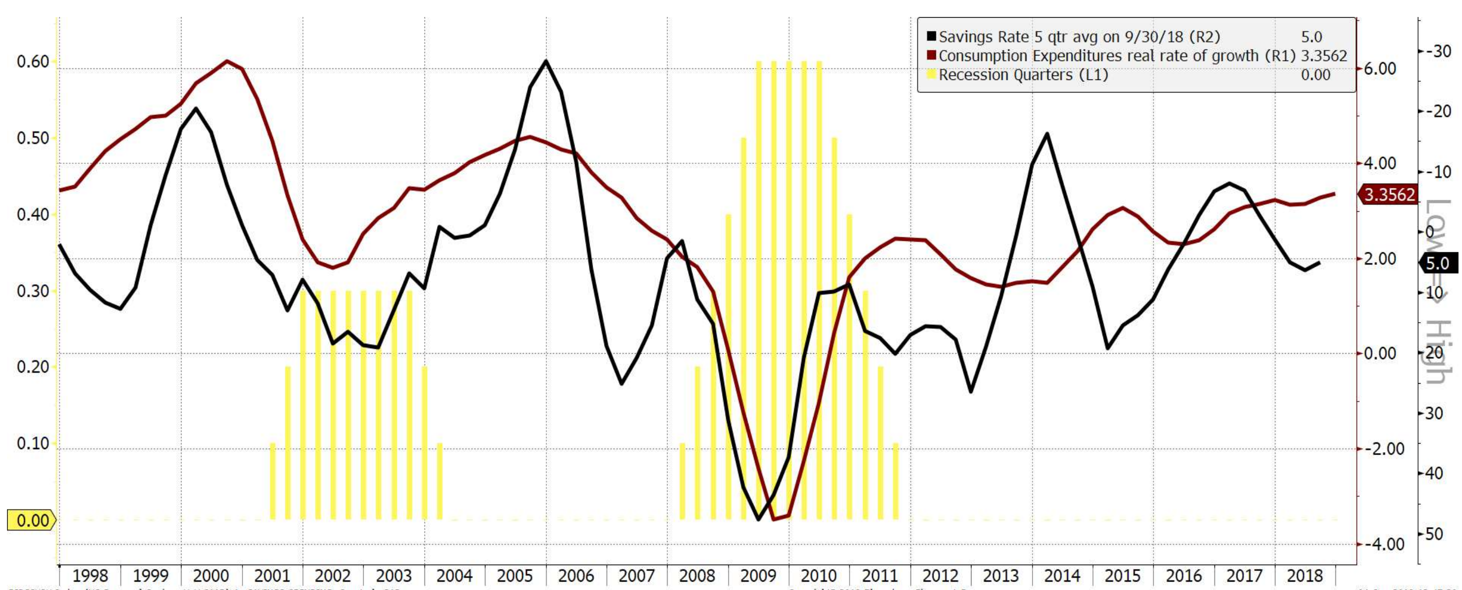


Market Returns Annually

Index	2015	2016	2017	2018
S&P 500	1.4	11.9	21.8	**-4.4%**
ML 1-5 yr Gov't/Corp	1.1	1.6	.4	**1.2%**
EAFE (Dev Fgn Mkts)	-.8	1.0	25.1	**-13.8%**
Emerging Markets	-14.6	11.8	37.9	**-14.5%**

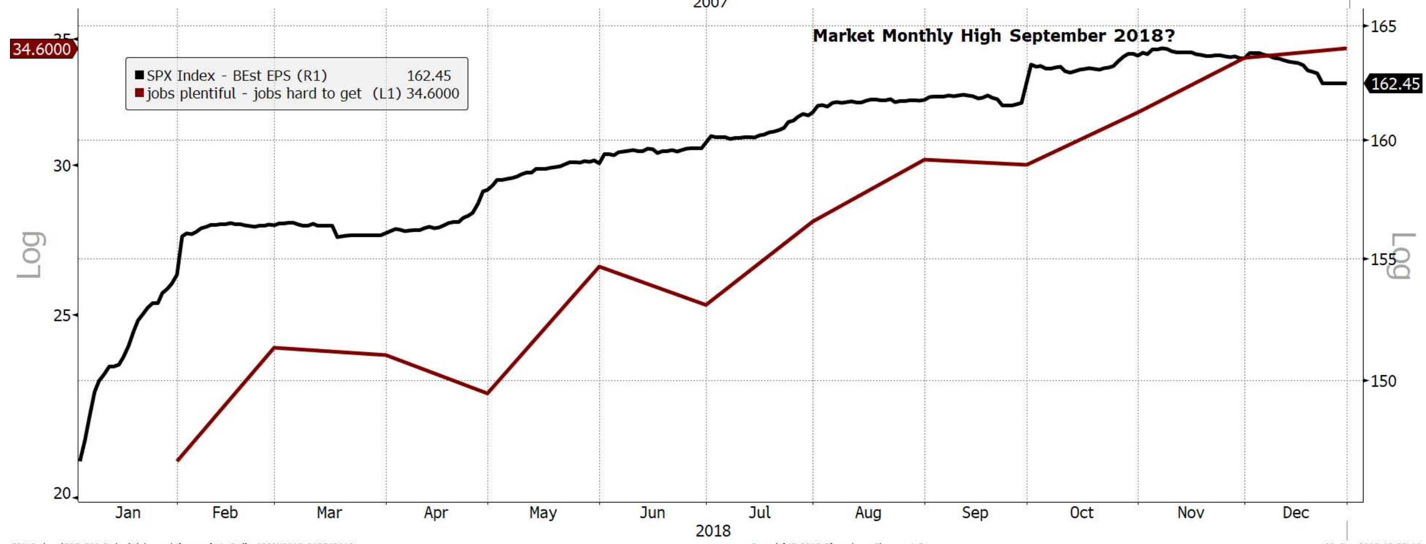
Panic Early?

The 14% drop in the S&P last quarter (and especially the 20% drop in the Russell 2000) were as dramatic as they were unexpected. While we have clearly been in very similar terrain as previous market tops, I'd say we were much more like 2006 than 2008. That is, in a place and time where excesses were likely to develop but without any signs that they had done so yet. My last Gleanings talked about the value of being under-invested in stocks when the economy was in peak territory and we do have a lot of money on the sidelines, but I still expect that with quite a few more quarters of good S&P 500 earnings to come, you can argue that we have seen all the downside that we are likely to see for the time being. On strictly valuation measures, we were probably 14% over-valued in September as cash flow for the S&P was up 29% since 2015 but the market was 47% higher. I might be putting too fine a point on it but a drop in the stock market does not predict a contraction in the economy any better than flipping a coin. I am still positive on the economy because consumers have been spending at a rate not seen in a decade and this time it's not being fueled by debt. In the chart below, when the black line representing the change in savings goes down, that indicates that people are saving more than they are spending. The big rise in the real rate of consumer spending in late 2005 was paid for out of savings as the -30% depletion in household net worth was used in home equity line of credit debit card expenditures. Today, we are seeing savings adding to consumers' balance sheet with income still greater than expenditures in spite of spending being at high levels. This is a much healthier environment with the solid job market and good increases in wage income (relative to the past) translating into higher personal consumption. We may have declining growth in global trade and the global economy, but domestic personal spending provides the lion's share of US economic growth, benefiting earnings and the stock market.



While wage growth is great for the economy, companies do push back when it impinges on profit growth. The three charts below show the last three economic peaks where the job market and S&P earnings both reversed course. The truth about recessions is that people don't lose their jobs because the economy contracts. The economy contracts when people lose their jobs. When the Federal Reserve talks about controlling inflation by raising interest rates, it's wage inflation to which they're referring. In 2000 and 2007, you could call the top of the economic cycle by looking for the reversal in the "jobs easy to get" survey. The peak in the number of people excited about job prospects comes as companies react to wage demands (especially in the context of rising interest rates) by offshoring and domestic plant closings. Fewer jobs brings less spending and so begins the cycle down. It remains to be seen if we have made that peak point yet. The economy will continue to expand as long as the job market does. We will be watching closely for a change in that to occur but it is still a little early in the cycle. The top in earnings and the stock market typically *follow* the peak in the job market.

SPX Index (S&P 500 Index) jobs and the market Daily 03JAN2000-31DEC2000 Copyright© 2019 Bloomberg Finance L.P. 03-Jan-2019 12:31:01



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Tom Lukic