WALL STREET STRATEGIES

Wall Street Strategies- providing independent stock market research since 1991 through a balanced approach to investing and trading

August 5 2019	Payne's Perspective Twin Winds

When everything seems to be going against you, remember that the airplane takes off against the wind, not with it.

-Henry Ford

Last week, the market struggled through its roughest week of 2019, as the twin winds of the Federal Reserve and the trade war swiftly shifted from tailwinds to headwinds. The stock market angst was evident all week into the Fed decision. While Jay Powell and company cut rates, his press conference revealed the human side, in the eyes of a man with presidential criticism and pressure.

While being human is only human, it can be dangerous when it might influence the Fed policy.

The market also took a hit last week after President Trump announced the next round of tariffs on Chinese imports. The news caught Wall Street off guard at a time when traders and investors were trying to figure out what just happened at the Fed. The confluence of both the Fed policy and more tariffs, which were poised to be backburner issues, have once again become headlines and headwinds.

The question for investors now is: can the market take off against these winds?

The Federal Reserve

Jay Powell cut rates as expected and announced an end to quantitative tightening (QT) this month instead of waiting until October.

However, the statement didn't have a sense of urgency or any fire about additional rate cuts. The only fire came during the question-and-answer period, where Jay Powell took (most of the) credit for the economy and dissed the trade war more than I can remember.

I think Jay Powell was taking shots at Trump on the authorship of the strong economy and dissing his fight with China on trade. I'm not sure he thought his whistles would be heard by politicians, but Senator Kamala Harris brought up the Fed during her latest Democrat debate:

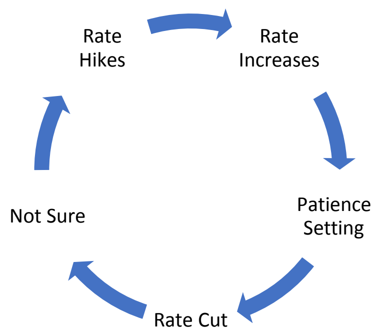
"Jerome Powell just dropped the interest rates, and he admitted why: because of this so-called trade policy that this president has — that has been nothing more than the Trump trade tax that has resulted in American families spending as much as $1.4 billion more on everything from shampoo to washing machines."

Harris took the bait and gave the Fed cover for cutting rates, making the issue and actions about Trump. This is very problematic. Jay Powell's emotions were on full display during the question-and-answer period, as he fought against the idea his Fed has made any miscues. I understand credibility is the biggest weapon the Fed possesses, but I think it only strengthens when there is an admission of mistakes.

There is no doubt Jay Powell disagrees, but the rate cut was a delayed effort to address unwarranted and dangerous rate hikes in 2018. There is a chance the urgency will grow over the next few months, which puts the Fed under extreme pressure to focus on preserving the expansion.

Powell has made no secret that he thinks the Fed saved the day during the Obama presidency doing all the heavy lifting to get the nation out of the throes of the Great Recession.

Pavlovian Reaction



It began with the very first question when asked if one 25 basis point (bps) rate cut would be enough. Powell stated that this has been more than one rate cut, and it has been an emotional journey that coaxed the best out of businesses, consumers, and the stock market.

By managing expectations, the Fed put everyone under a spell. It came into the year, hinting at "some rate increases," shifting into "patience setting," and finally carrying out that rate cut we have all been clamoring for.

According to Powell, over the course of the year, hinting at more accommodation had the economy perform just about as expected. Then he modestly said, "I wouldn't take the credit for all that, but it's clear it worked and has kept the economy on track."

Powell was able to deflect from low inflation threats and focus on the trade battle, but the economic data continues to suggest the Fed should have moved 50 basis points.

"Midcycle Adjustment"

By saying the Fed was making a midcycle adjustment, the suggestion is the Fed hasn't entered a long rating cutting cycle, but a short-term tweak.

Powell attempted to counter as he dropped enough hints that there is at least one more rate cut. However, the Street wants more and will probably get more for several reasons, including:

- Deflation risks
- Slowing economy
- Global economic decline
- Uncertainty over trade battle
- Insurance preserving economic expansion

Handicapping Fed Action

Currently, the Chicago Mercantile Exchange (CME) FedWatch sees a 96% chance of a 25- basis point (bps) rate cut in September, and a 55% chance of another 25-bps cut at the October Federal Open Market Committee (FOMC) gathering.

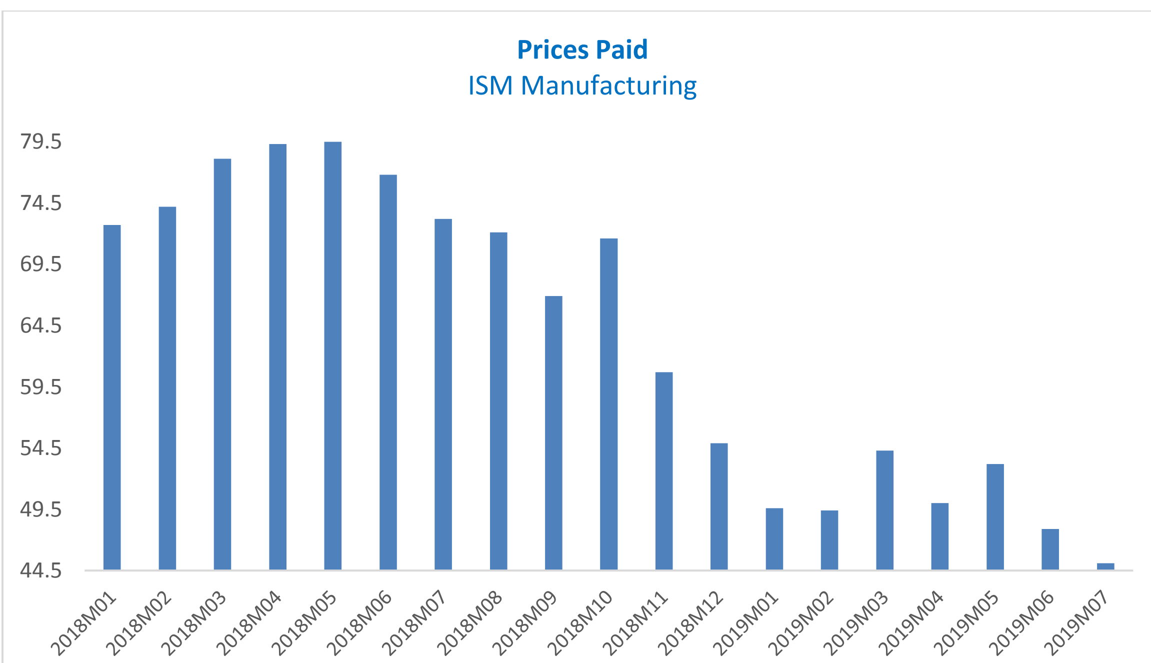
Rate Cut Probability	175-200	150-175	125-150	100-125
Sep 18, 2019	96.2%			
Oct 30, 2019	43.7%	54.2%	2.1%	
Dec 11, 2019	24.4%	49.5%	25.2%	0.9%

Red Flags

The day after the FOMC gathering, Jerome "Jay" Powell was ambiguous about the next move from the Fed Economic data released on Friday from the Institute for Supply Management (ISM) manufacturing and construction spending reports came in well below Wall Street's consensus.

I think the more worrisome part of the report is the prices paid, which underscores the notion deflation could be lurking. Prices paid are freefalling with July landing at its lowest level since May 2016. The chart of prices paid looks like a deflationary death spiral. What's more compelling is the first round of tariffs were supposed to send prices associated with manufacturing much higher. So, how come it's gone the other way?

These are questions Jay Powell should consider strongly.



Construction Spending also plunged 1.3% from June and -2.1% year-to-year. What's particularly worrisome is sharp declines in private; -12.0% for commercial and -15.3% in education.

Private 962,943,000,000
- Residential: 507,231,000,000
- Non-residential: 455,712,000,000

Public 324,055,000,000
- State & Local: 300,715,000,000
- Federal: 23,339,000,000

Total 1,286,997

Trade War

There's a chance tariffs on goods and services exported to the United States will cover an additional $300.0 billion. On the surface, 10% on $300.0 billion means $30.0 billion, which isn't a lot of money in a $20 trillion economy. There are ripples, and there is anxiety that must be acknowledged.

Wall Street had finally settled on the idea of a protracted trade battle with established lines of attack on both sides, including tariffs that have been in place for over a year. Like so many other challenges for investors, once the knowns are known, the would-be headwinds stop becoming obstacles.

Right now, I think there is only a 50% chance new tariffs will go into effect; if they do at some point, the market will factor them into prices, which would mean a worst-case scenario. That means near-term pain will present investing opportunities.

Watch List

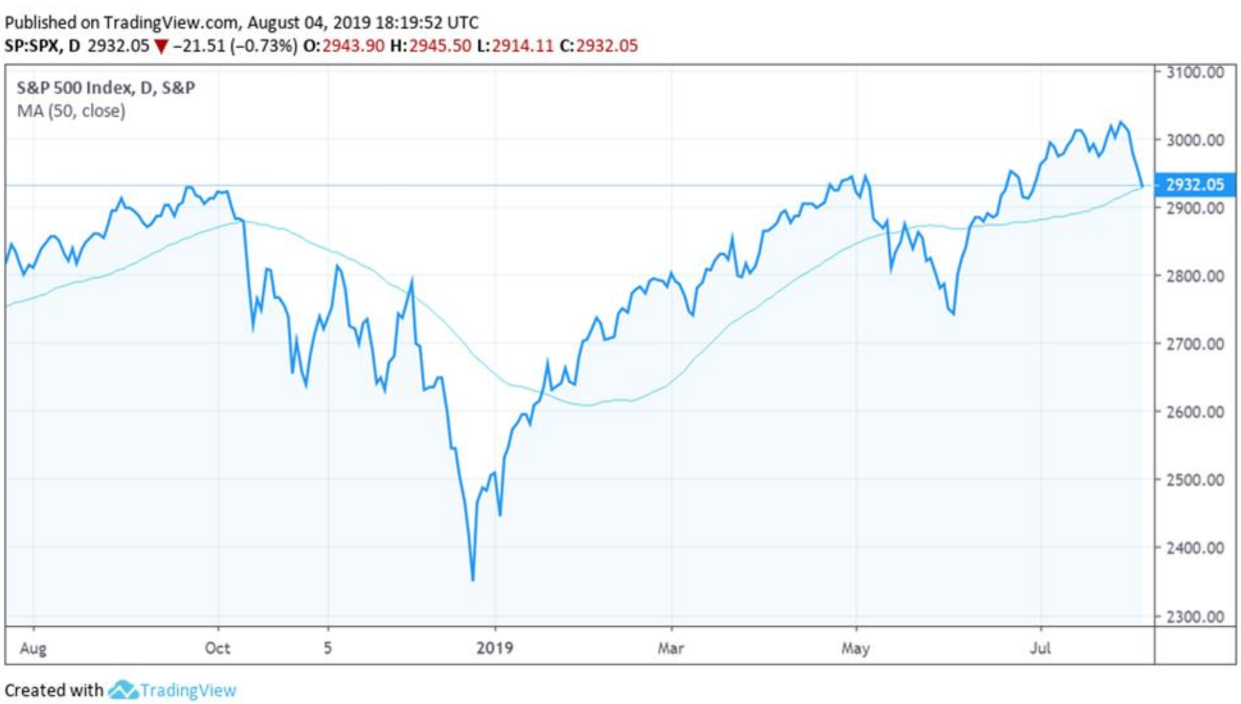
Semiconductor stocks got hit last week, in part to the reaction over the latest salvo in the trade war and reactions from earnings reports. Semiconductor Exchange-Traded Fund (ETF) (SMH) for last week were -6.3%, 2019 +29.7%, and five years +131.3%.

Chip stocks were also sold because they have made huge gains and all the news provided cover to take profits. That said, the latest salvo in the trade battle has nothing to do with chip stocks, which have already adjusted to current tariffs. Moreover, there will still be carve-outs for Huawei suppliers.

Texas Instruments (TXN) is high on my watch list as a potential new buy. Execution has been flawless, and the chart is very attractive. Pulling back and holding above $118 could be the buy signal.

Broad Market Support

Last Friday, all the major equity indices closed at or very close to their respective 50-day moving averages.



Now, the challenge is for them to hold, because once they fail, it's rare not to see 200-day moving averages tested soon thereafter.

Key Moving Averages	Dow	NASDAQ	S&P 500
50 Day	26,485	8,000	2,932
200 Day	25,556	7,551	2,790

The headwinds of the Fed rate policy and trade aren't changing immediately, so investors have to come to grips with emotions, and that means early in the week.

Charles Payne
Founder, CEO, & Principal Analyst
Wall Street Strategies

111 Town Square Place Suite 1510 – Jersey City, NJ 07310 - Phone 212.514.9500