STARBOARD ASSET MANAGEMENT

Risk Management for nagivating your future.

Starboard Weekly Report Ending October 5, 2018

Charts of the Week

These two charts are rather different. The top one is a weekly candle stick chart on the relative strength of the Russell 2000 (RUT) to the Dow. The bottom one is a Point and Figure chart of my favorite stock market indicator, the NYSE Bullish Percent and it has just reversed. Both are from StockCharts.com.

TECHNICAL

There are several takeaways from the top chart and they are all negative for the RUT. We own the inverse hedge Pro Shares Short Russell 2000 Index (RWM) and it will rise as the RUT declines. This is our major inverse hedge that goes with a market decline. The breakdowns that occurred below the 50 week average is very bearish and that is strong indication that this is just the start of the current backslide. This entire chart going back to July of 2016 indicates a weak relationship of the DOW to the RUT. Also, the 50 week moving average (blue line) has remained below the 200 week average going back to the beginning of the chart period. This should indicate a greater and more volatile decline for the RUT versus the DOW. All of the supporting charts have been declining since June of this year. For the past few weeks, despite new highs on the DOW, I have been very bearish and our bottom Point and Figure has now vindicated that position. This indicator is what I like to call my "Market Coach" because it rarely reverses on a false basis. It truly depicts the supply demand strength or weakness of the broader market because it is based on **2,800** NYSE listed companies versus the DOW's **30** companies. Please note how the most recent x column (right side of the bottom chart) made its high in June (marked by a 6). This price high is in a similar fashion to the RUT comparison in the top chart. Here we have yet another example of how for months the Dow has been masking the price deterioration that has been occurring with the overall market.

FUNDAMENTAL

There is no direct bearish correlation of small caps to higher interest rates, except that common sense would dictate that they should be more impacted than their large cap cousins. Speaking of large caps and interest rates, attached to your email is a Kimble chart study on the Treasury spread between the 2 year and 10 year yields and the corresponding tops of the S&P. The big risk in the small cap stocks, especially the top ten performing companies, is their high price earnings ratios (PE). Many of the top 10 in the RUT average are Biotech companies that are trading with no earnings at all. I calculated the PE for the top 10 and assigned 100 times to the non-earners and come up with 92.4 times earnings. By the time those crazy PE levels get back to reality this index could be down 70%.

ASIDE

"Businesses and households react to lower rates by investing and spending more. Lower rates also support the prices of housing and financial assets such as stock and bonds."
FED Chairman Jerome Powell

Obviously higher rates will create the opposite. The biggest economic question going forward is how long Chairman Powell will be able to raise rates. He and the FED are now discussing raising rates through all of next year. If they are able to continue increasing rates, then what Powell says regarding price support for housing and financial assets will disappear.

Please note:
It's the client's responsibility to notify Starboard of any changes that would in any way influence their financial requirements.