1. On the surface, I am surprised this most recent correction was so muted:

Consider:
   a. Weakening US economic data is leading to a growth (recession) scare.
   b. China tariff/trade tensions appear to be worsening.
   c. Threats of Mexican tariffs.
   d. Yield curve has reinverted.
   e. As of April 30, 2019, the S&P 500 was up 18% YTD (i.e., vulnerable).

Yet the S&P 500 peak (April 30th, 2019) to trough (June 3rd, 2019) was only down -6.8%.

**Is that all the bears can muster?**

2. Some view the meager pullback as investor complacency; implying that the risks above are not being priced appropriately.

I strongly disagree.

3. Here is a little fact that I think explains exactly why we have not seen a bigger drawdown:

   **Since 1940, we have never experienced two 10% drawdowns within 9 months of each other.**

   My explanation would be that skittish investors are so traumatized after the first 10% pullback they never reinvest. As a result, there is not enough ammunition for a second selloff of the same magnitude.
Consider:

a. The current % Bullish sentiment is 22%. The sentiment at the point of the December 2018 low which preceded a monster rally was 21%.²

b. Net long hedge fund exposure is about 5% (100% is the point of maximum bullishness). “Caution is eclipsing complacency.”³

c. Mutual fund and ETF net flows have been negative every month YTD, with the exception of February, which was barely positive.⁴

So it’s not complacency, but rather that investors are already prepared for the worst. In my opinion, that puts a floor on the magnitude of the drawdown.

Therefore, I suspect that the low of this correction is behind us….at least for now.

4. In the past, I have discussed that the period from just before US mid-term elections (end of Q3) to the end of the second quarter of the following year is historically an extremely good time for equities. Since 1946, the market has been higher during this period 100% of the time (18 out of 18 times).⁵

On September 30th, 2018, the S&P 500 was at 2,914. Either the S&P 500 will be above this level on June 30th, 2019 or the streak will be over. Although past performance is no guarantee of future results, I will go with 19 out of 19 times!

5. As I have also written in the past, a consistent pattern we have experienced in this current bull market is the retesting of corrections. These retests have tended to happen around two months following the first drawdown.⁶

If the most recent low was June 3rd, a mid-summer retest is entirely possible.

Of course, corrections happen for a reason. To me, a likely cause could be further anxiety about weakening growth, perhaps articulated during upcoming Q2 earnings reports. Time will tell, but that’s one possibility.

6. I continue to believe that 2019, a post-pause year, will be a good year for equities, with the S&P 500 north of 3,000 by the end of the year.

7. Portfolio Positioning

a. We are maintaining our Asia ex-Japan technology exposure, as much as that positioning has been painful lately. Chinese Internet stocks are down 20% since the April recovery high and are extraordinarily cheap versus their US comparables.⁷ What’s more, I do find it interesting that at the time when the Chinese government is helping their big Internet companies, our government is turning against ours. I would think that would result in a more narrow valuation gap.

b. Our global portfolios have roughly 20% allocated to Europe. It’s not huge, but it’s not nearly as negative as most others are positioned.

c. In the US, our portfolios are overweight growth, equal-weight bond proxy/defensives, and modestly underweight value. This positioning has definitely helped our recent performance.

A few points on this:

1. It is way too late to get defensive. Utilities and REITs were by far the best performing sectors in May.⁸ I suspect as we get further into the summer we may consider lightening up in these defensive sectors if and when we have some mid-summer chop.

2. Value is so under-owned (or even shorted) that ANY good news (such as a re-steepening of the yield curve or a Fed rate cut) could be a catalyst for a more sustainable equity rally. We think it’s still a little too early, but something we are focused on.

3. Growth remains king, at least for now.

As always, we are agnostic towards regions and styles.

Just calling it how we see it!

Andrew
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5 New York Times, Hed Davis Research
6 2010 retest 55 days later, 2011 retest 56 days later, 2018 retests, 53 and 56 days later.
7 As measured by the KWEB ETF index.
8 Factset.