Wealth Management International, Ltd.

Proactive Investment Management & Financial Planning

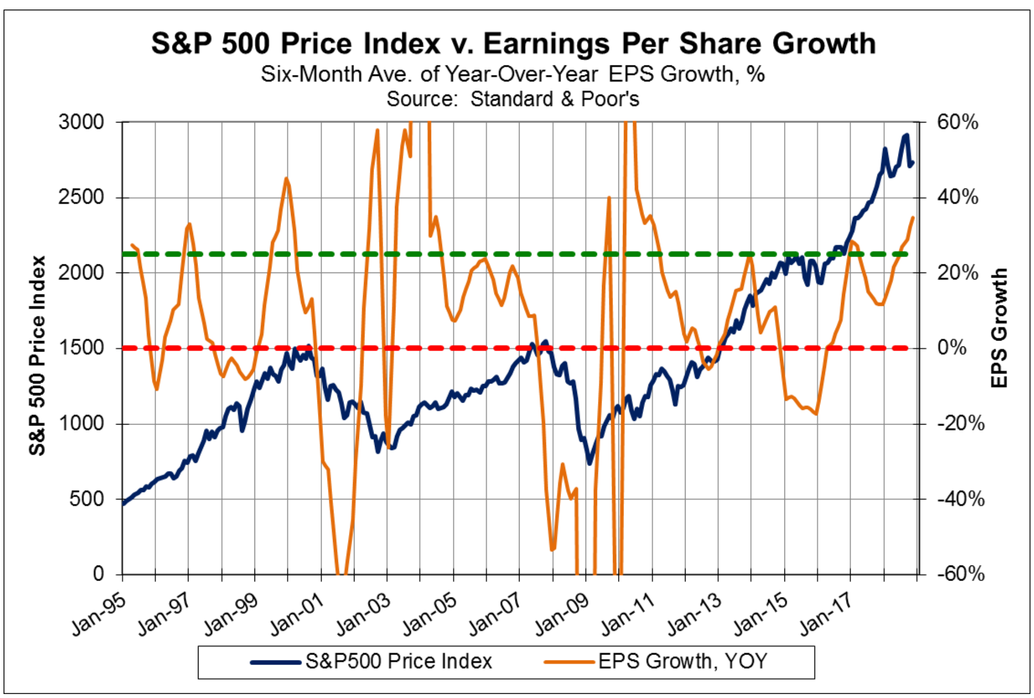
Economic Chart of the Week

November 21, 2018

The stock market is in another downdraft, and sellers have the upper hand over buyers again. The big question is: What do the sellers see that has them so concerned? As we've noted before, the only major indicator that looks negative to us is that valuations are elevated. And that's not necessarily a problem because stocks can stay richly valued for years at a time.

Importantly, other economic and financial fundamentals continue to look encouraging. In this week's chart, for example, the gold line shows that earnings per share (EPS) are still growing robustly. The year-over-year growth in EPS is now well above the 25% level that has historically been associated with particularly good stock markets (see the dashed green line in the chart). The chart also shows that EPS growth has historically had to drop below 0% (the dashed red line in the chart) before stock prices entered a bear market, as in late 2000 and late 2007. The continued growth in EPS is a key reason why we think the recent stock selling is simply a re-pricing of stocks as investors belatedly focus on the developing longer-term risks that we've been talking about all year, such as rising inflation, higher interest rates and protectionist trade policies. Those longer-term risks convinced us to start ratcheting down our exposure to stocks back in August, but the rest of the market is doing so only now. Once prices have fallen enough to account for those risks, we think buyers will step in and take control again, driving the market higher. Since we already cut risk in late summer, and since we expect stocks to eventually start to rebound, our response to the October and November sell-off has been limited to some purchases of beaten-down stocks in our most aggressive strategies and, early this week, a further shedding of technology-related stocks in our most conservative portfolios. We think that should be sufficient for now, but we wouldn't hesitate to take further steps if the selling starts to get out of hand.

Patrick Fearon, CFA
Chief Investment Officer



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