Starfox Financial Services, LLC

June 19, 2017

MARKET SNAPSHOT

DJIA	**21384**
Nasdaq	**6152**
S&P 500	**2433**
Comex GOLD	**$1246**

(closing values June 16, 2017)

Caution Ahead!

As the stock market marches deeper into record territory we see clear signs that a correction is increasingly likely. Continued easy money policy in the US and throughout the world has kept short term rates near zero, in an effort to stimulate economic growth. Yet, worldwide economic growth remains quite sluggish. The continually rising stock market has not only priced in a number of economic improvements and possible policy changes, but its current valuation suggests investors are anticipating greater improvements and more significant growth than is likely to occur. As a result, the markets have become overvalued and excessively risky. The bond market on the other hand has seen bond values continue to creep up, resulting in ever lower yields despite the Federal Reserve having just raised short term rate targets. Plainly put, with Treasury yields near the lows of the year and the stock market at/near all-time highs, bonds and stocks are signaling two very different things about the direction of the economy.

Stocks continue to set and remain near record highs, driven mostly by a small number of companies whose stock prices have surged. The Tech sector has dominated the surge with relatively minimal participation from the broader market. Confirming the lack of breadth is the fact that over the past 3 months typical S&P 500 stocks have risen only 0.5% while the index as a whole is up about 2.5%. With slower than anticipated economic growth, increasing labor costs, hopes for any sort of tax reform fading and continued uncertainty over health care, investors are beginning to question whether the broader market will ever participate in the rally. We believe the markets are significantly overvalued and the lack of strong participation from the broader market, along with fading auto sales and poor retail numbers, are a few of the many indicators suggesting a top is near.

As is often the case, the bond market may be seeing the things more clearly and be providing better insight into the longer term direction of the economy. The 10-year Treasury yield continues to trade near the low end of a very tight range, getting ever closer to the 2-year treasury yield. The convergence of the two results in a flattening of the yield curve, which is a negative indicator suggesting concern about a weaker economy or that the Fed may raise rates (or tighten monetary policy) too quickly. Since a flattening of the yield curve typically occurs preceding economic recession, the convergence of the 10-year treasury and the 2-year note yields would seem to suggest bond investors are anticipating a recession 12-18 months out.

We are concerned with the current valuations of the stock market and agree with the bond market's suggestion that a significant slowing of the economy or even a recession is likely to occur in the months ahead. Many areas are already seeing significant wage pressures. As the labor market continues to tighten, we expect to see increased wage inflation resulting in higher labor costs. As employers absorb the increasing costs of labor, we will see much more subdued earnings growth and eventually a significant economic slow-down or recession. Tax reform and fiscal and regulatory policy changes may delay a recession or (more likely) hasten a recovery, but we feel the path to recession has already begun.

We continue to view the markets push to new highs as more of a blow off than a sign of systemic strength and recommend reducing risk and taking profits. It is always difficult to gauge just how far a market with too little fear will run before it eventually turns around, but we know the current levels are built on optimism and lofty expectations more than accurate valuation. We believe the pullback/correction will provide attractive buying opportunities, and are generally positive about the markets growth following a well formed pullback/correction.

Adding to our concerns is the fact that the Federal Reserve has indicated it will be reducing its balance sheet in the months ahead. Never in history has the Fed held such a large balance sheet nor attempted to make such a significant reduction in holdings. Without a historical reference it is difficult to judge what impact the balance sheet reduction will have on the financial markets. Reducing the balance sheet is effectively a reversal of QE, so we expect it to reduce liquidity which may put additional pressure on the stock and bond markets.

Our recommendation is to reduce or eliminate exposure to longer dated bonds in favor of very short term high quality bonds, and to hold more cash/cash like investments than we might normally consider. We feel these measures will add some current protection and better prepare portfolios for opportunities that may arise.

It is at these valuations that most investors often feel they are missing out on something. Don't be fooled. Most of the gains have been made. It is now very risky to try and chase returns as the market peaks. Opportunity comes to those who are patient.

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