Jack Adamo's Insiders Plus

Your source for Insider insights and exceptional analysis

July 9, 2016

Dear Friend & Client,

Thanks for joining me.

It was another good week for us and the market in general. Stocks exploded after the Non-farm Payrolls Report showed booming growth of 287K jobs in June. It was helped by the return of 35K striking Verizon workers, just as last month's 38K figure was hurt by the strike. Combined, the two months show a decent 162.5K jobs average, which is decent by recent standards. April and May numbers were revised downward by a combined 11K.

Then there's the household survey.

The Non-farm Payrolls Report has two sections. One is done by surveying businesses; the other is done by surveying homes. Both methods have their problems, but the business survey uses a lot of questionable estimates along with the survey, the worst of which is the "birth/death" rate estimate of new business creation. As I discussed recently, its assumptions simply do not reflect today's employment environment. There has been at least one month recently where the entire net gain in jobs was due to this adjustment. Job growth would have been negative without it.

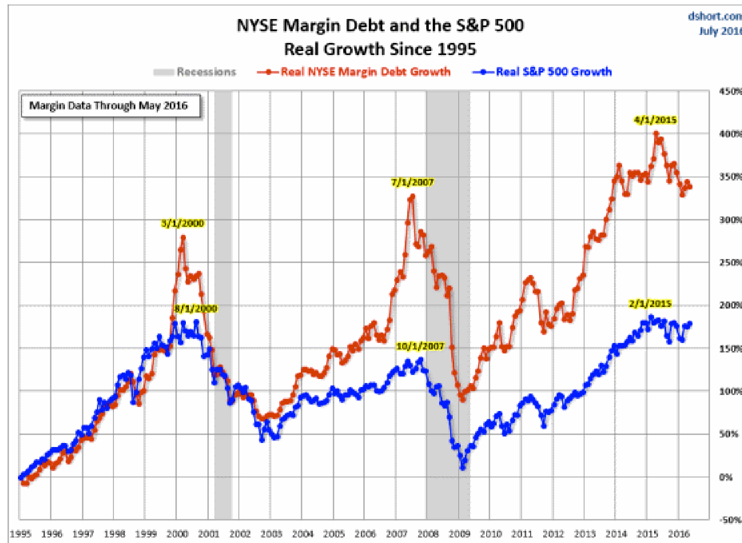
I don't know if the Household Survey has any estimated inputs that are so egregiously off base, but this month's report was disturbing, to say the least. *The Household Survey says that in June the number of unemployed persons increased by 347,000 to 7.8 million*.

Economic Landscape

I mentioned last week that Deutsche Bank said it saw a 60% chance of a recession in the next 12 months. This week the bank said "We can't think of a time when the S&P was more disjointed from everything." The company's stock has been getting killed lately, so maybe it's just making excuses about why it's doing poorly. Still, hearing these things from a major investment bank is certainly unusual.

An economics site I read regularly showed a few mixed signals on the recession subject. That's not surprising, given the unprecedented Fed interference in the stock market, which is one of the larger inputs in the BEA's economic forecast. Below is a chart of an indicator we've looked at before. Coupled with the high market valuations, this one continues to worry me. Below is the text that went with the set of charts accompanying the piece. The italics are mine.

"There are too few peak/trough episodes in this overlay series to take the latest credit-balance data as a leading indicator of a major selloff in U.S. equities. *However, current level is well off its record close in April of last year and showing a pattern similar to what we saw following the market peaks in 2000 and 2008*. This has been an interesting indicator to watch in recent months and will certainly continue to bear close watching in the months ahead."



(Chart courtesy of AdvisorPerspectives.com/Dshort)

The above is not the credit-balance data chart. That chart is too complex. This margin-debt chart conveys the same information more clearly. The amount of borrowing to buy stocks this cycle hit an all-time high by any metric. The fact that it is coming down is *not* comforting. That's what it does before we enter a recession and the market crashes. In 2000 it took about a year from the peak to when the recession started. In 2008 it was a few months shorter.

Of course, the volume and persistence of intervention by the Fed and other Central Banks may extend that period by an amount we can't determine. Considering valuations, however, it seems prudent not to bank too much on this anomaly lasting forever.

Earnings Outlook

The S&P 500 is now expected to post its fifth consecutive quarter of negative earnings growth. Adjusted Q2 earnings are expected to decline 5.6% -- slightly less than the 6.8% year-on-year decline in the first quarter. However, the decline in estimates is accelerating. On March 31, the estimated earnings decline for Q2 was only 2.8%. So, we'll have to wait for the final tally, which in any case, will not be good.

Revenues are also on track to decline. *If they do, it will be for the sixth quarter in a row* and will mark the first time the index has seen six consecutive quarters of year-over-year declines in sales since S&P FactSet began tracking the data in Q3 2008.

But analysts expect earnings growth and revenue growth to return in the second half of 2016. Earnings are expected to grow 0.7% for Q3 and 7.2% for Q4. Revenue rebounds are expected to be even more impressive at 2.2% and 5.1%.

I also expect this to happen, a few months after pigs fly.

Despite all of the above, the S&P 500 is one point away from making a new all-time nominal high. With just one strong day, the Dow Industrials could make one as well. Uncharacteristically, the NASDAQ is lagging. So is the Russell 2000, but that's more normal. Thinking it through, this makes sense only with a herd mindset that is risk-averse on one hand, but feels it must get some kind of return on its money; so it is putting it in "safe" stocks and high-dividend payers. Barron's this week told of a bizarre instance where a closed-end fund is selling at a premium of more than 100% above net asset value because it is paying a 10% dividend, which, however, is achieved by leverage (buying stocks on margin). I don't want to be around those poor fools when the market comes down.

Gold & Silver

For the sixth week in a row, gold has gone up more than a full percent. The latest rise was 2%. Normally I would think we'd be due for a correction, but normal isn't getting much traction so far this year. On average, June is usually a down month. The first week in July starts the metal soaring through year end, except for a brief respite in late October.

One would think the unusual strength in gold would be linked to a weakening dollar, based on the likelihood that the Fed will not raise rates this year, and may even restart quantitative easing. However, that's not the case. The dollar has been quite strong the last couple of weeks, if only because the Euro and Yen are so weak. So, Deutsche Bank has some cover when it says none of the usual metrics apply anymore. I've been saying it for a few years.

Everything I just said about gold should apply to silver as well. Maybe even more so. Throughout the current bull market in precious metals, gold has been steadier and ultimately done better, but the big run-up in 2011 saw silver spike briefly to catch up. Hence, silver may continue to be the bigger mover for a while.

Oil Update

Oil finally gave back some of its gains. West Texas Intermediate prices dropped 7.5% this week. The reports didn't say much of anything they haven't been screaming for months; maybe traders are just coming out of their trances. There were some small differences, but nothing that should explain the drop in prices. The North American rig count rose a little; most weeks it is down slightly. However, production actually declined slightly from last year's comparable week, but that small positive was ignored. Here are the details:

- U.S. production was up 10.7% from last week, but down 2.1% year-over-year.
- Combined production & imports left supply up 3.8% for the week, but down 0.9% year-over-year.
- U.S. crude oil inventories are up 12.6% year-over-year, down slightly from last week's 13.1% overage.

The oil industries comprise, the only group in our portfolios that showed a drop of more than 1% this week. The result was our High Income Portfolio rose only 0.4% compared to 1.4% for the three major indices. Our Main Portfolio rose 1.5%.

There are no portfolio updates this week.

You can view all of our holdings with their current advice by going to:
http://www.jackadamo.com/main.asp?fn=portfolio_view.asp

The password is: **TinaFey**

New subscribers please note:

Occasionally an e-mail notification will not reach all subscribers. This is usually due to your internet provider changing its SPAM filters after which it interprets our notification as SPAM. Please make sure you have us "white-listed" if you have a feature in your email client, and/or put our email address jack@jackadamo.com in your address book. That may solve the problem. Also note that you should keep an old notification message from us in a hold folder. You can click on the link in it at any time, even months later, and *it will always bring you to the most current newsletter*.

Be aware that you can look up all the original write-ups on any stock in our portfolios by clicking on the symbol on the portfolio page. The original write-up is usually the first mention in any newsletter (although sometimes a stock has been re-recommended later); so, you'd want to pull up the letters oldest first. To see *recent* comments, click on the link that reverses that and brings up newest write-ups first.

Please see the important legal notice at the end of this letter.

***

Despite the continued pitiful showing in earnings, the market looks like it wants to go higher. With this much Fed involvement, it may take a full-fledged, two-sigma (two standard deviations) rise in adjusted P/Es before the market cracks. We're not far off now, but it could hold out until next year with the help of more stock buybacks (though they are waning) and the exclusion of more "non-recurring items" in companies' earnings reports, which analysts and the financial media will embrace without question.

Assuming the market makes a new high and holds it for a week or so, we'll close our hedges. In the meantime, you're okay to buy any of our stocks within their buy ranges, but I wouldn't add to our hedges at this time.

That's it for today. I look forward to talking with you again soon.

Jack

Questions? Write to Jack at: jack@jackadamo.com

Important Legal Notice

This publication contains Jack Adamo's opinions. No recommendation or statement made in this publication, regardless of how strongly or positively rendered, should be construed as anything except Jack Adamo's personal opinion.

Jack Adamo makes economically feasible efforts to verify facts and calculations set forth in this publication, but errors can and will occur from time to time. The publisher cannot guarantee that any misstatement of fact, or any miscalculation will be discovered or corrected prior to or after publication.

Jack Adamo passed the New York State CPA exam, but is not a practicing CPA. Please get tax advice from a qualified personal tax advisor. Jack Adamo is not a Registered Investment Advisor, nor is he required to be. He cannot judge the suitability of any investment for an individual reader without knowing their circumstances, financial goals, risk tolerance, etc. All investments mentioned in this publication entail some degree of risk. All information is provided on a "use at your own risk" basis. Past results are not necessarily indicative of future performance.